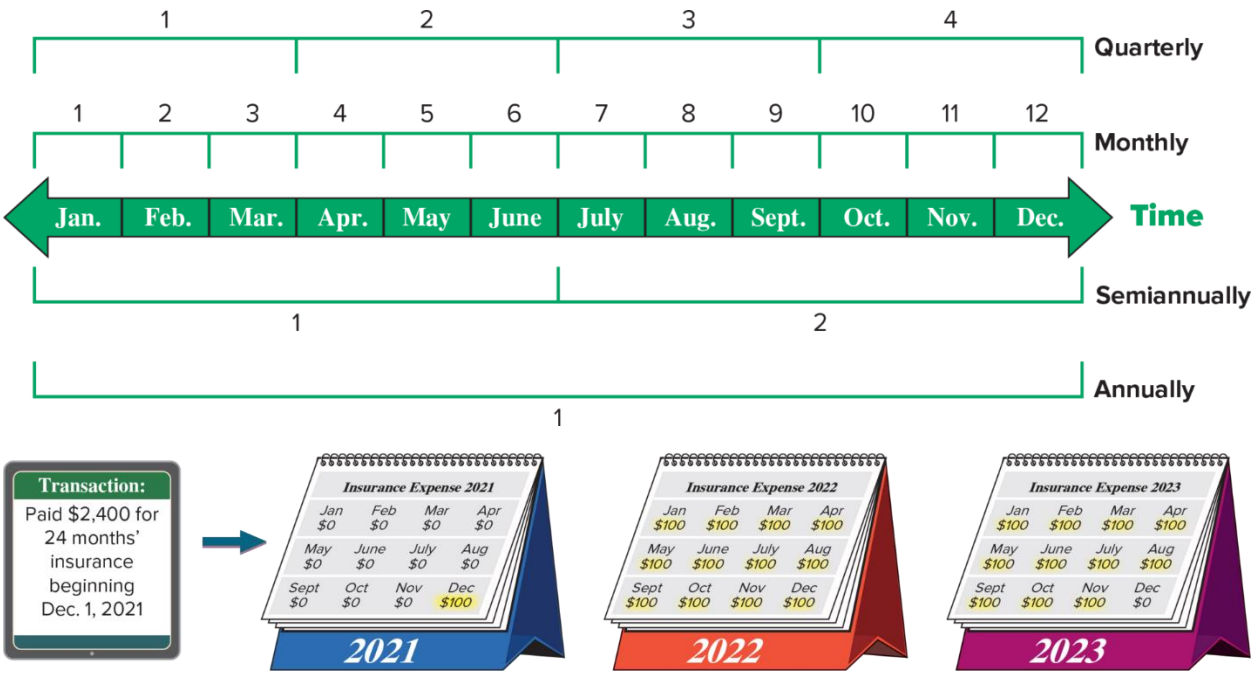
Page 84 3 Adjusting Accounts for Financial Statements Chapter Preview DEFERRAL OF EXPENSE C1Timing Accrual vs. cash 3-Step process P1Framework Examples NTK 3-1 DEFERRAL OF REVENUE P2Framework Examples NTK 3-2 ACCRUED EXPENSE P3Framework Examples NTK 3-3 ACCRUED REVENUE P4Framework Examples Summary NTK 3-4 REPORTING P5Adjusted trial balance Financial statements A1Profit margin NTK 3-5 Learning Objectives CONCEPTUAL C1Explain the importance of periodic reporting and the role of accrual accounting. ANALYTICAL A1Compute and analyze profit margin. PROCEDURAL P1Prepare adjusting entries for deferral of expenses. P2Prepare adjusting entries for deferral of revenues. P3Prepare adjusting entries for accrued expenses. P4Prepare adjusting entries for accrued revenues. P5Prepare financial statements from an adjusted trial balance. P6Appendix 3A—Explain the alternatives in accounting for prepaids.Page 85 Leading the Way “Whatever you dream, you can do’’ —Emily Núñez Cavness DENVER—Emily Núñez Cavness co-founded Sword & Plough (SwordandPlough.com) while deployed in Afghanistan. “It was not the usual startup location,’’ recalls Emily as she describes a Skype meeting interrupted by mortar fire. Emily and her sister Betsy recycle military surplus materials to create totes, handbags, backpacks, and accessories. The sisters reuse materials that “would otherwise be burned or buried.’’ Bart Young/Invision for Intuit/AP Images Emily and Betsy have already recycled 30,000 pounds of materials. They stress their success is in part due to the accounting system. “We were able to pinpoint some immediate problems to solve,’’ explains Emily. They describe how moving from a cash to an accrual system gave more timely information. Emily insists the information “didn’t just stay stored on my iPhone, or scrap piece of paper—we took action!’’ Accounting adjustments that increased the value of revenue and expense data were used to better set prices and manage costs. Accounting analytics helped Emily and Betsy with business decisions and overall idea development. “We took the idea seriously,’’ exclaims Emily, “and today . . . [it is] a powerful reality.’’ “It has been challenging,’’ admits Emily. “I want Sword & Plough to be a leader in the field of social entrepreneurship.’’ Hoo-ah! Sources: Sword & Plough website, January 2021; ABC News, August 2014; Military Times, September 2015; NationSwell, January 2016; HuffPost, October 2017; Facebook, 2019

TIMING AND REPORTING The Accounting Period C1 Explain the importance of periodic reporting and the role of accrual accounting. The value of information is linked to its timeliness. Useful information must reach decision makers frequently. To provide timely information, accounting systems prepare reports at regular intervals. The time period assumption presumes that an organization’s activities can be divided into specific time periods such as a month, a three-month quarter, a six-month interval, or a year. Exhibit 3.1

shows various accounting, or reporting, periods. Most organizations use a year as their primary accounting period. Reports covering a one-year period are known as annual financial statements. Many organizations also prepare interim financial statements covering one, three, or six months of activity. EXHIBIT 3.1 Accounting Periods The annual reporting period is not always a calendar year ending on December 31. An organization can use a fiscal year consisting of any 12 consecutive months or 52 weeks. For example, Gap's fiscal year consistently ends the final week of January or the first week of February each year. Companies with little seasonal variation in sales often use the calendar year as their fiscal year. Netflix uses calendar-year reporting. Companies that have seasonal variations in sales often use a natural business year end, which is when sales are at their lowest level for the year. The natural business year for retailers such as Target and Nordstrom ends around January 31, after the holidays. Page 86 Accrual Basis versus Cash Basis After external transactions and events are recorded, several accounts require adjustments before their balances appear in financial statements. This is needed because internal transactions and events are not yet recorded. Accrual basis accounting records revenues when services and products are delivered and records expenses when incurred (matched with revenues). Cash basis accounting records revenues when cash is received and records expenses when cash is paid. Cash basis income is cash receipts minus cash payments. Most agree that accrual accounting better reflects business performance than cash basis accounting. Accrual accounting also increases the comparability of financial statements from period to period. Accrual Basis To compare these two systems, let's consider FastForward's Prepaid Insurance account. FastForward paid $2,400 for 24 months of insurance coverage that began on December 1, 2021. Accrual accounting requires that $100 of insurance expense be reported each month, from December 2021 through November 2023. (This means expenses are $100 in 2021, $1,200 in 2022, and $1,100 in 2023.) Exhibit 3.2 shows this allocation of insurance cost across the three years. Any unexpired premium is reported as a Prepaid Insurance asset on the accrual basis balance sheet. EXHIBIT 3.2 Accrual Accounting Accrual Basis 2021 2022 2023 Insurance expense $100 $1,200 $1,100 Cash Basis A cash basis income statement for December 2021 reports insurance expense of $2,400, as shown in Exhibit 3.3. The cash basis income statements for years 2022 and 2023 report no insurance expense. The cash basis balance sheet never reports a prepaid insurance asset because it is immediately expensed. Also, cash basis income for 2021–2023 does not match the cost of insurance with the insurance benefits received for those years. EXHIBIT 3.3 Cash Accounting Cash Basis 2021 2022 2023 Insurance expense $2,400 $0 $0 Recognizing Revenues and Expenses We divide a company's activities into time periods, but not all activities are complete when financial statements are prepared. Thus, adjustments are required to get proper account balances. We use two principles in the adjusting process: revenue recognition and expense

recognition. Revenue recognition principle requires that revenue be recorded when goods or services are provided to customers and at an amount expected to be received from customers. Adjustments ensure revenue is recognized (reported) in the time period when those services and products are provided. Expense recognition (or matching) principle requires that expenses be recorded in the same accounting period as the revenues that are recognized as a result of those expenses. Page 87 Framework for Adjustments Four types of adjustments exist for transactions and events that extend over more than one period. Adjustments are made using a 3-step process, as shown in Exhibit 3.4. EXHIBIT 3.4 Three-Step Process for Adjusting Entries Step 1: Determine what the current account balance equals. Step 2: Determine what the current account balance should equal. Step 3: Record an adjusting entry to get from step 1 to step 2. Each adjusting entry made at the end of an accounting period reflects a transaction or event that is not yet recorded. An adjusting entry affects one or more income statement accounts and one or more balance sheet accounts (but never the Cash account).


1
2
3
4
Quarterly
1 2 3 4 5 6 7 8 9 10 11 12
Monthly
Jan. Feb. Mar. Apr. May June July Aug. Sept. Oct. Nov. Dec.
Time
Semiannually
1
2
Annually
1
Transaction:
Paid $2,400 for 24 months' insurance beginning Dec. 1, 2021
Insurance Expense 2021
Jan $0 Feb $0 Mar $0 Apr $0
May $0 June $0 July $0 Aug $0
Sept $0 Oct $0 Nov $0 Dec $100
2021
Insurance Expense 2022
Jan $100 Feb $100 Mar $100 Apr $100
May $100 June $100 July $100 Aug $100
Sept $100 Oct $100 Nov $100 Dec $100
2022
Insurance Expense 2023
Jan $100 Feb $100 Mar $100 Apr $100
May $100 June $100 July $100 Aug $100
Sept $100 Oct $100 Nov $100 Dec $0
2023

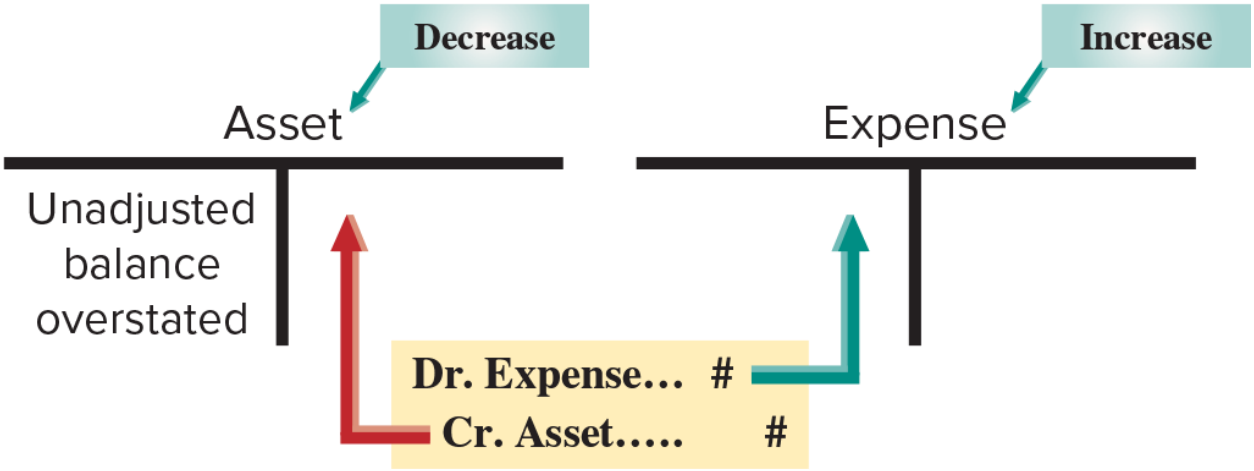
DEFERRAL OF EXPENSE P1 Prepare adjusting entries for deferral of expenses. Prepaid expenses, or deferred expenses, are assets paid for in advance of receiving their benefits. When these assets are used, those advance payments become expenses. Framework Adjusting entries for prepaid expenses increase expenses and decrease assets, as shown in the T-accounts of Exhibit 3.5. This adjustment shows the using up of prepaid expenses.

To demonstrate accounting for prepaid expenses, we look at prepaid insurance, supplies, and depreciation. In each case we decrease an asset (balance sheet) account and increase an expense (income statement) account. EXHIBIT 3.5 Adjusting for Prepaid Expenses (decrease an asset and increase expense) Prepaid Insurance Prepaid insurance expires with time. We use our three-step process. Step 1: We determine that the current balance of FastForward's prepaid insurance is equal to its $2,400 payment for 24 months of insurance benefits that began on December 1, 2021. Step 2: The benefits of the insurance expire over time and a portion of the Prepaid Insurance asset becomes expense. For FastForward, one month's insurance coverage expires by December 31, 2021. This expense is $100, or 1/24 of $2,400, which leaves $2,300. Step 3: The adjusting entry to record this expense and reduce the asset, along with T-account postings, follows. Page 88 Explanation After adjusting and posting, the $100 balance in Insurance Expense and the $2,300 balance in Prepaid Insurance are ready for reporting in financial statements. The following highlights the adjustment for prepaid insurance. Before Adjustment Adjustment After Adjustment Prepaid Insurance = $2,400 Deduct $100 from Prepaid Insurance Add $100 to Insurance Expense Prepaid Insurance = $2,300 Reports $2,400 policy for 24 months' coverage. Record current month's $100 insurance expense and $100 reduction in prepaid. Reports $2,300 in coverage for remaining 23 months. Supplies We count supplies at period-end and make an adjusting entry. Step 1: FastForward purchased $9,720 of supplies in December, some of which were used during that same month. When financial statements are prepared at December 31, the cost of supplies used during December is expensed. Step 2: When FastForward computes (physically counts) its remaining unused supplies at December 31, it finds $8,670 of supplies remaining of the $9,720 total supplies. The $1,050 difference between these two amounts is December's supplies expense. Step 3: The adjusting entry to record this expense and reduce the Supplies asset account, along with T-account postings, follows. Explanation The balance of the Supplies account is $8,670 after posting—equaling the cost of the remaining supplies. The following highlights the adjustment for supplies. Before Adjustment Adjustment After Adjustment Supplies = $9,720 Deduct $1,050 from Supplies Add $1,050 to Supplies Expense Supplies = $8,670 Reports $9,720 in supplies. Record $1,050 in supplies used and $1,050 as supplies expense. Reports $8,670 in supplies. Other Prepaid Expenses Other prepaid expenses, such as Prepaid Rent and Prepaid Advertising, are accounted for exactly as insurance and supplies are. Some prepaid expenses are both paid for and fully used up within a single period. One example is when a company pays monthly rent on the first day of each month. In this case, we record the cash paid with a debit to Rent Expense instead of an asset account. Depreciation A special category of prepaid expenses is plant assets, also called Property, Plant & Equipment (PP&E). Plant assets are long-term tangible assets used to produce and sell products and services. Examples include buildings, machines, vehicles,

and equipment. Plant assets provide benefits for more than one period. All plant assets (excluding land) eventually wear out or become less useful. Page 89 The costs of plant assets are gradually reported as expenses in the income statement over the assets' useful lives (benefit periods). Depreciation is the allocation of the costs of these assets over their expected useful lives, but it does not necessarily measure decline in market value. Depreciation expense is recorded with an adjusting entry similar to that for other prepaid expenses. Point: An asset's expected value at the end of its useful life is called salvage value. Step 1: FastForward purchased equipment for $26,000 in early December to use in earning revenue. This equipment's cost must be depreciated. Step 2: The equipment is expected to have a useful life (benefit period) of five years and to be worth about $8,000 at the end of five years. This means the net cost of this equipment over its useful life is $18,000 ($26,000 − $8,000). FastForward depreciates it using straight-line depreciation, which allocates equal amounts of the asset's net cost to depreciation during its useful life. Dividing the $18,000 net cost by the 60 months (5 years) in the asset's useful life gives a monthly cost of $300 ($18,000/60). Step 3: The adjusting entry to record monthly depreciation expense, along with T-account postings, follows. Explanation After posting the adjustment, the Equipment account ($26,000) minus its Accumulated Depreciation ($300) account equals the $25,700 net cost. The $300 balance in the Depreciation Expense account is reported in the December income statement. The following highlights the adjustment for depreciation. Before Adjustment Adjustment After Adjustment Equipment, net = $26,000 Deduct $300 from Equipment, net Add $300 to Depreciation Expense Equipment, net = $25,700 Reports $26,000 in equipment. Record $300 in depreciation and $300 as accumulated depreciation. Reports $25,700 in equipment, net of accumulated depreciation. Accumulated Depreciation is a separate contra account and has a normal credit balance. A contra account is an account linked with another account, it has an opposite normal balance, and it is reported as a subtraction from that other account's balance. FastForward's contra account of Accumulated Depreciation—Equipment is subtracted from the Equipment account in the balance sheet. The Accumulated Depreciation contra account includes total depreciation expense for all prior periods for which the asset was used. To demonstrate, on February 28, 2022, after three months of adjusting entries, the Equipment and Accumulated Depreciation accounts appear as in Exhibit 3.6. The $900 balance in the Accumulated Depreciation account is subtracted from its related $26,000 asset cost. The difference ($25,100) between these two balances is called book value, or net amount, which is the asset's costs minus its accumulated depreciation. EXHIBIT 3.6 Accounts after 3 Months of Depreciation Table Summary: Two T-accounts with account name and number above the horizontal line. The T-account on the left contains a left-side debit entry. The T-account on the right contains three right-side credit entries as well as a balance amount. Equipment 167 Dec.

3 26,000 Accumulated Depreciation—Equipment 168 Dec. 31 300 Jan. 31 300 Feb. 28 300 Balance 900 These account balances are reported in the assets section of the February 28 balance sheet. Exhibit 3.7 shows two ways to report plant assets. Page 90 EXHIBIT 3.7 Reporting Equipment and Accumulated Depreciation Decision Maker Caia Image/Image Source Investor A publisher signs an Olympic athlete to write a book. The company pays the athlete $500,000 to sign plus future book royalties. A note to the company's financial statements says, "prepaid expenses include $500,000 in author signing fees to be matched against future expected sales." How does this affect your analysis? ■ Answer NEED-TO-KNOW 3-1 Prepaid Expenses P1 For each separate case below, follow the three-step process for adjusting the prepaid asset account at December 31. Assume no other adjusting entries are made during the year. Prepaid Insurance. The Prepaid Insurance account has a $5,000 debit balance to start the year, and no insurance payments were made during the year. A review of insurance policies shows that $1,000 of unexpired insurance remains at its December 31 year-end. Prepaid Rent. On October 1 of the current year, the company prepaid $12,000 for one year of rent for facilities being occupied from that day forward. The company debited Prepaid Rent and credited Cash for $12,000. December 31 year-end statements must be prepared. Supplies. The Supplies account has a $1,000 debit balance to start the year. Supplies of $2,000 were purchased during the current year and debited to the Supplies account. A December 31 physical count shows $500 of supplies remaining. Accumulated Depreciation. The company has only one plant asset (equipment) that it purchased at the start of this year. That asset had cost $38,000, had an estimated life of 10 years, and is expected to be valued at $8,000 at the end of the 10-year life. December 31 year-end statements must be prepared. Solution Step 1:Prepaid Insurance equals $5,000 (before adjustment) Step 2:Prepaid Insurance should equal $1,000 (the unexpired part) Step 3:Adjusting entry to get from step 1 to step 2 Table Summary: Three-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third line, explanation of the transaction. Dec. 31 Insurance Expense 4,000 Prepaid Insurance 4,000 Record expired insurance coverage ($5,000 − $1,000). Step 1:Prepaid Rent equals $12,000 (before adjustment) Step 2:Prepaid Rent should equal $9,000 (the unexpired part)* Step 3:Adjusting entry to get from step 1 to step 2 Table Summary: Four-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third and fourth lines, explanation of the transaction. Dec. 31 Rent Expense 3,000 Prepaid Rent 3,000 Record expired prepaid rent. *$12,000 − $3,000 = $9,000, where $3,000 is from: ($12,000/12 months) × 3 months Step 1:Supplies equal $3,000 (from $1,000 + $2,000; before adjustment) Step 2:Supplies should equal $500 (what's left) Step 3:Adjusting entry to get from step 1 to step 2* Table Summary: Four-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount.

Third and fourth lines, explanation of the transaction. Dec. 31 Supplies Expense 2,500 Supplies 2,500 Record supplies used. *$1,000 + $2,000 purchased − $500 remaining = $ 2,500 supplies used Step 1:Accumulated Depreciation equals $0 (before adjustment) Step 2:Accumulated Depreciation should equal $3,000 (after current-period depreciation of $3,000)* Step 3:Adjusting entry to get from step 1 to step 2 Table Summary: Three-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third line, explanation of the transaction. Dec. 31 Depreciation Expense—Equipment 3,000 Accumulated Depreciation—Equipment. 3,000 Record depreciation for period. *($38,000 − $8,000)/10 years Do More: QS 3-5, QS 3-6, QS 3-7, QS 3-8, QS 3-9



Insurance

Dec. 1 Pay insurance premium and record asset

Prepaid Insurance..... 2,400

Cash..... 2,400

Two-Year Insurance Policy
Total cost is $2,400
Monthly cost is $100

Dec. 31 Coverage expires and record expense

	Adjustment (*a*)	
Dec. 31	Insurance Expense	100
	Prepaid Insurance	100
	Record first month's expired insurance.	

Prepaid Insurance 128

Dec. 1	2,400	Dec. 31	100
Balance	2,300		

Insurance Expense 637

Dec. 31	100		

	Adjustment (*b*)		
Dec. 31	Supplies Expense	1,050	
	Supplies		1,050
	Record supplies used.		

Supplies 126

Dec.	2	2,500	**Dec. 31**	**1,050**
	6	7,100		
	26	120		
Balance		8,670		

Supplies Expense 652

Dec. 31	**1,050**		

Depreciation
Dec. 3 Purchase equipment and record asset
Equipment..... 26,000
Cash..... 26,000
Dec. 31 Allocate asset cost and record depreciation

	Adjustment (*c*)		
Dec. 31	Depreciation Expense	300	
	Accumulated Depreciation—Equipment		300
	Record monthly equipment depreciation.		

Assets = Liabilities + Equity
−300 −300

Equipment		167
Dec. 3	26,000	

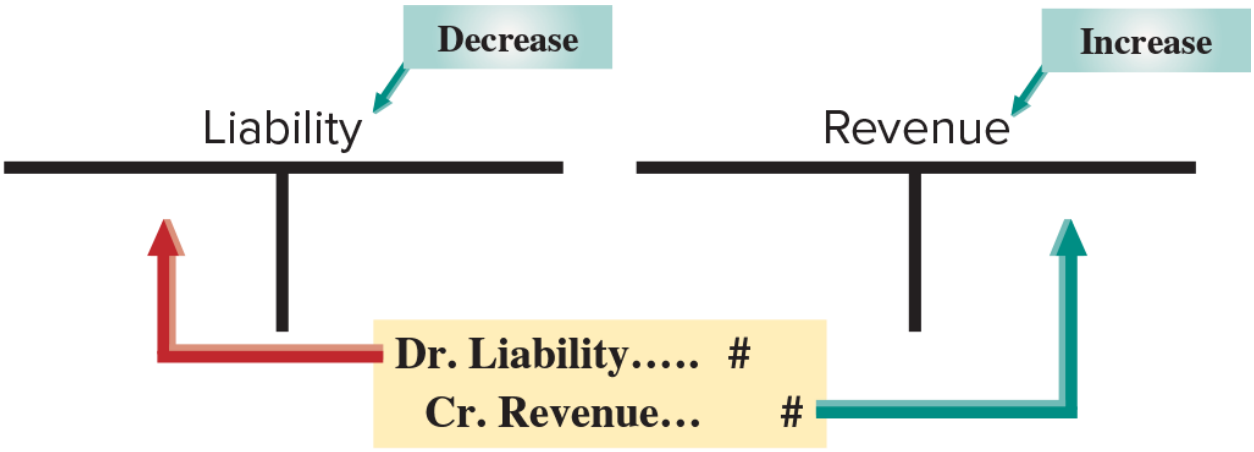
Accumulated Depreciation—Equipment		168
	Dec. 31	300

Depreciation Expense—Equipment		612
Dec. 31	300	

Page 91 DEFERRAL OF REVENUE P2 Prepare adjusting entries for deferral of revenues. Unearned revenue is cash received in advance of providing products and services. Unearned revenues, or deferred revenues, are liabilities. When cash is accepted, an obligation to provide products or services is accepted. We defer, or postpone, reporting

amounts received as revenues until the product or service is provided. Framework As products or services are provided, the liability decreases and the unearned revenues become revenues. Adjusting entries for unearned revenue decrease the unearned revenue (balance sheet) account and increase the revenue (income statement) account, as shown in Exhibit 3.8. EXHIBIT 3.8 Adjusting for Unearned Revenues (decrease a liability and increase revenue) Unearned revenues are common in sporting and concert events. When the Boston Celtics receive cash from advance ticket sales, they record it in an unearned revenue account called Deferred Game Revenues. The Celtics record revenue as games are played. Unearned Consulting Revenue FastForward has unearned revenues. The company agreed on December 26 to provide consulting services to a client for 60 days for a fixed fee of $3,000. Step 1: On December 26, the client paid the 60-day fee in advance, covering the period December 27 to February 24. The entry to record the cash received in advance is Table Summary: Four-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third and fourth lines, explanation of the transaction. Dec. 26 Cash 3,000 Unearned Consulting Revenue 3,000 Received advance payment for services over the next 60 days. This advance payment increases cash and creates a liability to do consulting work over the next 60 days (5 days this year and 55 days next year). Step 2: As time passes, FastForward earns this payment through consulting. By December 31, it has provided five days' service and earned 5/60 of the $3,000 unearned revenue. This amounts to $250 ($3,000 × 5/60). The revenue recognition principle requires that $250 of unearned revenue be reported as revenue on the December income statement. Step 3: The adjusting entry to reduce the liability account and recognize revenue, along with T-account postings, follows. Explanation The adjusting entry transfers $250 from unearned revenue (a liability account) to a revenue account. The following highlights the adjustment for unearned revenue. Page 92 Before Adjustment Adjustment After Adjustment Unearned Consulting Revenue = $3,000 Deduct $250 from Unearned Consulting Revenue Add $250 to Consulting Revenue Unearned Consulting Revenue = $2,750 Reports $3,000 in unearned revenue for consulting services promised for 60 days ($50 per day). Record 5 days of earned consulting revenue, which is 5/60 of unearned amount. Reports $2,750 in unearned revenue for consulting services owed over next 55 days (55 days × $50 = $2,750). Ethical Risk LifeJourneys/iStock/Getty Images Clawbacks from Accounting Fraud Former executives at Saba Software, a cloud-based talent management system, were charged with accounting fraud by the SEC for falsifying revenue to boost income. This alleged overstatement of income led to a payback of millions of dollars to the company by the former CEO and former CFO. See SEC release 2015–28. ■ NEED-TO-KNOW 3-2 Unearned Revenues P2 For each separate case below, follow the three-step process for adjusting the unearned revenue liability account at December 31. Assume no other adjusting entries are made during the year. Unearned Rent Revenue. The

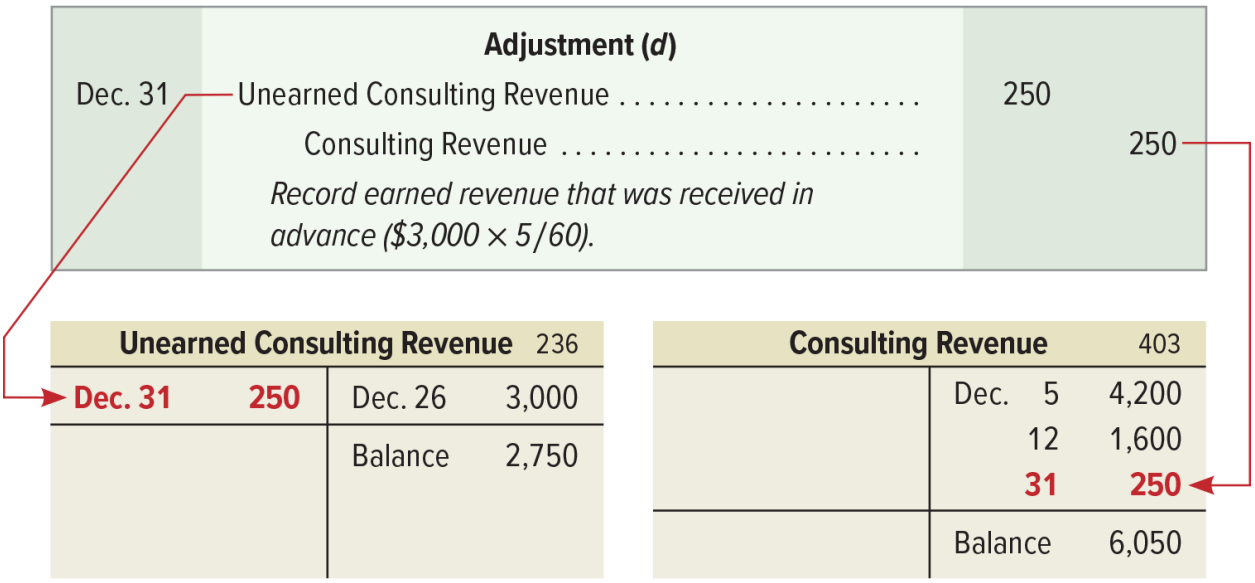
company collected $24,000 rent in advance on September 1, debiting Cash and crediting Unearned Rent Revenue. The tenant was paying 12 months' rent in advance and moved in on September 1. Unearned Services Revenue. The company charges $100 per month to spray a house for insects. A customer paid $600 on November 1 in advance for six treatments, which was recorded with a debit to Cash and a credit to Unearned Services Revenue. At year-end, the company has applied two treatments for the customer. Solution Step 1:Unearned Rent Revenue equals $24,000 (before adjustment) Step 2:Unearned Rent Revenue should equal $16,000 (current-period earned revenue is $8,000*) Step 3:Adjusting entry to get from step 1 to step 2 Table Summary: Four-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third and fourth lines, explanation of the transaction. Dec. 31 Unearned Rent Revenue 8,000 Rent Revenue 8,000 Record earned portion of rent received in advance. *($24,000/12 months) × 4 months' rental usage Step 1:Unearned Services Revenue equals $600 (before adjustment) Step 2:Unearned Services Revenue should equal $400 (current-period earned revenue is $200*) Step 3:Adjusting entry to get from step 1 to step 2 Table Summary: Four-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third and fourth lines, explanation of the transaction. Dec. 31 Unearned Services Revenue 200 Services Revenue 200 Record earned portion of revenue received in advance. *$100 × 2 treatments = Services revenue Do More: QS 3-10, QS 3-11, QS 3-12



Unearned Revenues

Dec. 26 Cash received in advance and record liability

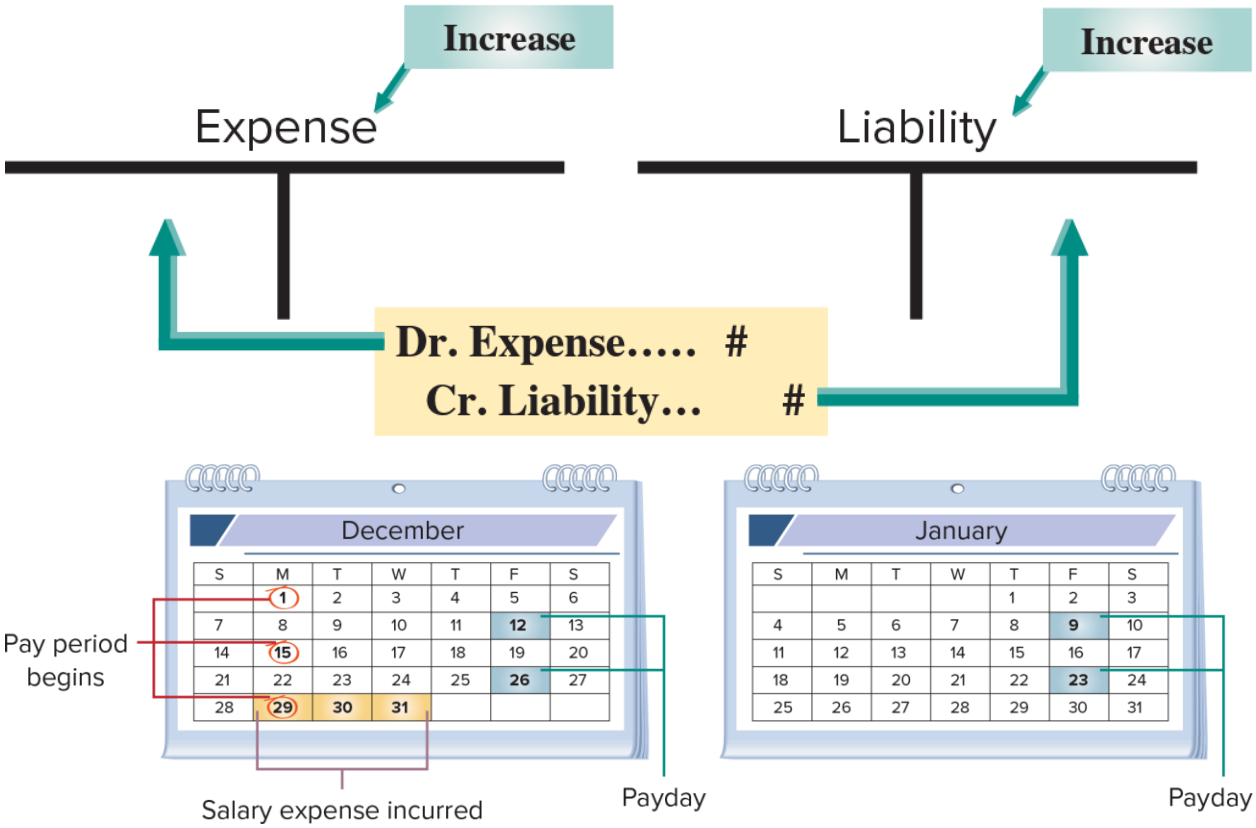
Dec. 31 Provided 5 days of services and record revenue


Adjustment (d)
Dec. 31
Unearned Consulting Revenue 250
Consulting Revenue 250
Record earned revenue that was received in advance ($3,000 × 5/60).
Unearned Consulting Revenue 236
Dec. 31 250
Dec. 26 3,000
Balance 2,750
Consulting Revenue 403
Dec. 5 4,200
12 1,600
31 250
Balance 6,050

ACCRUED EXPENSE P3 Prepare adjusting entries for accrued expenses. Accrued expenses, or accrued liabilities, are costs that are incurred in a period that are both unpaid and unrecorded. Accrued expenses are reported on the income statement for the period when incurred. Framework Adjusting entries for recording accrued expenses increase the expense (income statement) account and increase a liability (balance sheet) account, as shown in Exhibit 3.9. This adjustment recognizes expenses incurred in a period but not yet paid. Common examples of accrued expenses are salaries, interest, rent, and taxes. We use salaries and interest to show how to adjust accounts for accrued expenses. EXHIBIT 3.9 Adjusting for Accrued Expenses (increase a liability and increase expense) Page 93 Accrued Salaries Expense FastForward's employee earns $70 per day, or $350 for a five-day workweek beginning on Monday and ending on Friday. Step 1: Its employee is paid every two weeks on Friday. On December 12 and 26, the wages are paid, recorded in the journal, and posted to the ledger. Step 2: The calendar in Exhibit 3.10 shows three working days after the December 26 payday (29, 30, and 31). This means the employee has earned three days' salary by the close of business on Wednesday, December 31, but this salary cost has not been paid or recorded. FastForward must report the added expense and liability for unpaid salary from December 29, 30, and 31. EXHIBIT 3.10 Salary Accrual and Paydays Step 3: The adjusting entry for accrued salaries, along with T-account postings, follows. Explanation Salaries expense of $1,610 is reported on the December income statement, and $210 of salaries payable (liability) is reported in the balance sheet. The following highlights the adjustment for salaries incurred. Before Adjustment Adjustment After Adjustment Salaries Payable = $0 Add $210 to Salaries Payable Add $210 to Salaries Expense Salaries Payable = $210 Reports $0 from employee salaries incurred but not yet paid in cash. Record 3 days' salaries owed, but not yet paid, at $70 per day. Reports $210 salaries payable to employee but not yet paid. Accrued Interest Expense Companies

accrue interest expense on notes payable (loans) and other long-term liabilities at the end of a period. Interest expense is incurred as time passes. Unless interest is paid on the last day of an accounting period, we need to adjust for interest expense incurred but not yet paid. This means we must accrue interest cost from the most recent payment date up to the end of the period. The formula for computing accrued interest is Principal amount owed × Annual interest rate × Fraction of year since last payment Ghing/Shutterstock If a company has a $6,000 loan from a bank at 5% annual interest, then 30 days' accrued interest expense is $25—computed as $6,000 × 0.05 × 30/360. The adjusting entry debits Interest Expense for $25 and credits Interest Payable for $25. Point: Interest computations use a 360-day year, called the bankers' rule. Page 94 Future Cash Payment of Accrued Expenses Accrued expenses at the end of one accounting period result in cash payment in a future period(s). Recall that FastForward recorded accrued salaries of $210. On January 9, the first payday of the next period, the following entry settles the accrued liability (salaries payable) and records salaries expense for seven days of work in January. Table Summary: Four-line journal entry. First line contains date, account and debit amount. Second line, account and debit amount. Third line, account and credit amount. Fourth line, explanation of the transaction. Jan. 9 Salaries Payable (3 days at $70 per day) 210 Salaries Expense (7 days at $70 per day) 490 Cash 700 Paid two weeks' salary including three days accrued. The $210 debit is the payment of the liability for the three days' salary accrued on December 31. The $490 debit records the salary for January's first seven working days (including the New Year's Day holiday) as an expense of the new accounting period. The $700 credit records the total amount of cash paid to the employee. NEED-TO-KNOW 3-3 Accrued Expenses P3 For each separate case below, follow the three-step process for adjusting the accrued expense account at December 31. Assume no other adjusting entries are made during the year. Salaries Payable. At year-end, salaries expense of $5,000 has been incurred by the company but is not yet paid to employees. Interest Payable. At its December 31 year-end, the company holds a mortgage payable that has incurred $1,000 in annual interest that is neither recorded nor paid. The company will pay the interest on January 3 of the next year. Solution Step 1:Salaries Payable equals $0 (before adjustment) Step 2:Salaries Payable should equal $5,000 (not yet recorded) Step 3:Adjusting entry to get from step 1 to step 2 Table Summary: Three-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third line, explanation of the transaction. Dec. 31 Salaries Expense 5,000 Salaries Payable 5,000 Record accrued salaries expense. Step 1:Interest Payable equals $0 (before adjustment) Step 2:Interest Payable should equal $1,000 (not yet recorded) Step 3:Adjusting entry to get from step 1 to step 2 Table Summary: Three-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third line, explanation of the transaction. Dec. 31 Interest Expense 1,000 Interest Payable

1,000 Record interest incurred but not yet paid. Do More: QS 3-13, QS 3-14, E 3-6, E 3-7, E 3-8



	Adjustment (e)		
Dec. 31	Salaries Expense	210	
	Salaries Payable		210
	Record three days' accrued salary (3 × $70).		

Salaries Expense		622
Dec. 12	700	
26	700	
31	210	
Balance	1,610	

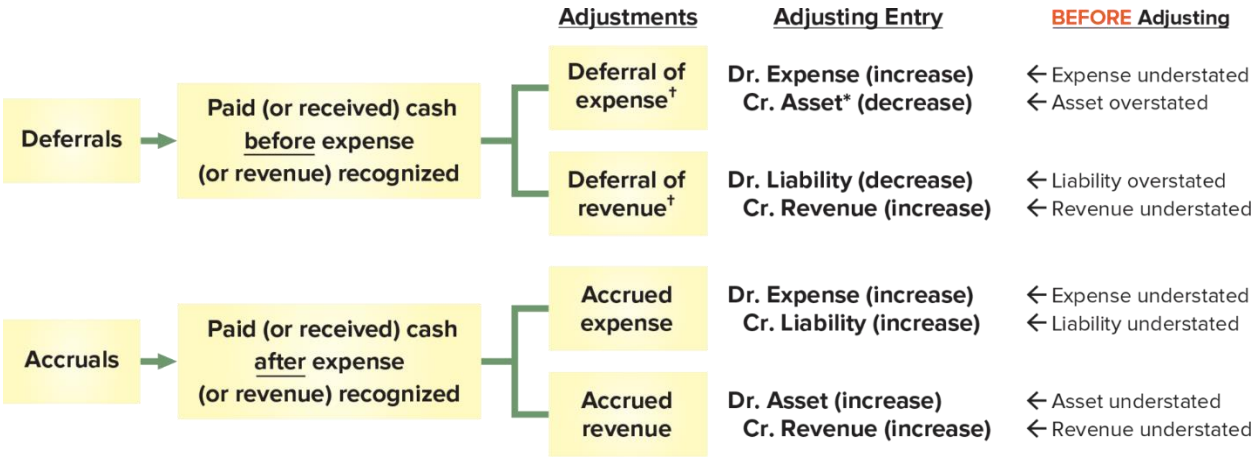
Salaries Payable		209
	Dec. 31	210

ACCRUED REVENUE P4 Prepare adjusting entries for accrued revenues. Accrued revenues are revenues earned in a period that are both unrecorded and not yet received in cash (or other assets). An example is a technician who bills customers after the job is done. If one-

third of a job is complete by the end of a period, then the technician must record one-third of the expected billing as revenue in that period—even though there is no billing or collection. Accrued revenues are also called accrued assets. Framework The adjusting entries for accrued revenues increase a revenue (income statement) account and increase an asset (balance sheet) account, as shown in Exhibit 3.11. Accrued revenues usually come from services, products, interest, and rent. We use services and interest to show how to adjust for accrued revenues. EXHIBIT 3.11 Adjusting for Accrued Revenues (increase an asset and increase revenue) Page 95 Accrued Services Revenue Accrued revenues are recorded when adjusting entries are made at the end of the accounting period. These accrued revenues are earned but unrecorded because either the buyer has not yet paid or the seller has not yet billed the buyer. FastForward provides an example. Step 1: In the second week of December, FastForward agreed to provide 30 days of consulting services to a fitness club for a fixed fee of $2,700 (or $90 per day). FastForward will provide services from December 12 through January 10, or 30 days of service. The club agrees to pay FastForward $2,700 on January 10 when the service is complete. Step 2: At December 31, 20 days of services have already been provided. Because the contracted services have not yet been entirely provided, FastForward has neither billed the club nor recorded the services already provided. Still, FastForward has earned two-thirds of the 30-day fee, or $1,800 ($2,700 × 20/30). The revenue recognition principle requires FastForward to report the $1,800 on the December income statement. The balance sheet reports that the club owes FastForward $1,800. Step 3: The adjusting entry for accrued services, along with T-account postings, follows. Explanation Accounts receivable are reported on the balance sheet at $1,800, and the $7,850 total of consulting revenue is reported on the income statement. The following highlights the adjustment for accrued revenue. Before Adjustment Adjustment After Adjustment Accounts Receivable = $0 Add $1,800 to Accounts Receivable Add $1,800 to Consulting Revenue Accounts Receivable = $1,800 Reports $0 from revenue earned but not yet received in cash. Record 20 days of earned revenue, which is 20/30 of total contract. Reports $1,800 in accounts receivable from services provided. Accrued Interest Revenue If a company is holding notes receivable that produce interest revenue, we must adjust the accounts to record any earned and yet uncollected interest revenue. The adjusting entry is similar to the one for accruing services revenue. Specifically, debit Interest Receivable (asset) and credit Interest Revenue. Future Cash Receipt of Accrued Revenues Accrued revenues at the end of one accounting period result in cash receipts in a future period(s). Recall that FastForward made an adjusting entry for $1,800 to record 20 days' accrued revenue earned from its consulting contract. When FastForward receives $2,700 cash on January 10 for the entire contract amount, it makes the following entry to remove the accrued asset (accounts receivable) and record revenue earned in January. The $2,700 debit is the cash received. The $1,800 credit is the removal of

the receivable, and the $900 credit is revenue earned in January. Page 96 Table Summary: Four-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third line, account and credit amount. Fourth line, explanation of the transaction. Jan. 10 cash 2,700 Accounts Receivable (20 days at $90 per day) 1,800 Consulting Revenue (10 days at $90 per day) 900 Received cash for accrued asset and recorded earned consulting revenue for January. Analytics Insight Wit Olszewski/Shutterstock We Accept Bitcoin Microsoft, Subway, Expedia, and others accept Bitcoin as a form of payment. Bitcoin is a digital currency that can be bought and sold. In recent years, one Bitcoin has been worth between $500 and $20,000. Companies accepting Bitcoin must ensure their accounting system properly accounts for rapid changes in Bitcoin value when setting a sales price. ■ NEED-TO-KNOW 3-4 Accrued Revenues P4 For each separate case below, follow the three-step process for adjusting the accrued revenue account at December 31. Assume no other adjusting entries are made during the year. Accounts Receivable. At year-end, the company has completed services of $1,000 for a client, but the client has not yet been billed for those services. Interest Receivable. At year-end, the company has earned, but not yet recorded, $500 of interest earned from its investments in government bonds. Solution Step 1:Accounts Receivable equals $0 (before adjustment) Step 2:Accounts Receivable should equal $1,000 (not yet recorded) Step 3:Adjusting entry to get from step 1 to step 2 Table Summary: Three-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third line, explanation of the transaction. Dec. 31 Accounts Receivable 1,000 Services Revenue 1,000 Record accrued revenue. Step 1:Interest Receivable equals $0 (before adjustment) Step 2:Interest Receivable should equal $500 (not yet recorded) Step 3:Adjusting entry to get from step 1 to step 2 Table Summary: Three-line journal entry. First line contains date, account and debit amount. Second line, account and credit amount. Third line, explanation of the transaction. Dec. 31 Interest Receivable 500 Interest Revenue 500 Record accrued interest. Do More: QS 3-3, QS 3-15, QS 3-16, E 3-9 through E 3-13 Links to Financial Statements Exhibit 3.12 summarizes the four adjustments. Each adjusting entry affects one or more income statement (revenue or expense) accounts and one or more balance sheet (asset or liability) accounts, but never the Cash account. EXHIBIT 3.12 Summary of Adjustments *For depreciation, the credit is to Accumulated Depreciation (contra asset). †Exhibit assumes that deferred expenses are initially recorded as assets and that deferred revenues are initially recorded as liabilities. Page 97 Decision Ethics Financial Officer At year-end, the president instructs you, the financial officer, not to record accrued expenses until next year because they will not be paid until then. The president also directs you to record in current year sales a recent purchase order from a customer that requires merchandise to be delivered two weeks after

the year-end. Your company would report a net income instead of a net loss if you follow these instructions. What do you do? ■ Answer



Adjustment (*f*)

Dec. 31	Accounts Receivable	1,800	
	Consulting Revenue		1,800
	Record 20 days' accrued revenue.		

Accounts Receivable 106

Dec. 12	1,900	Dec. 22	1,900
31	1,800		
Balance	1,800		

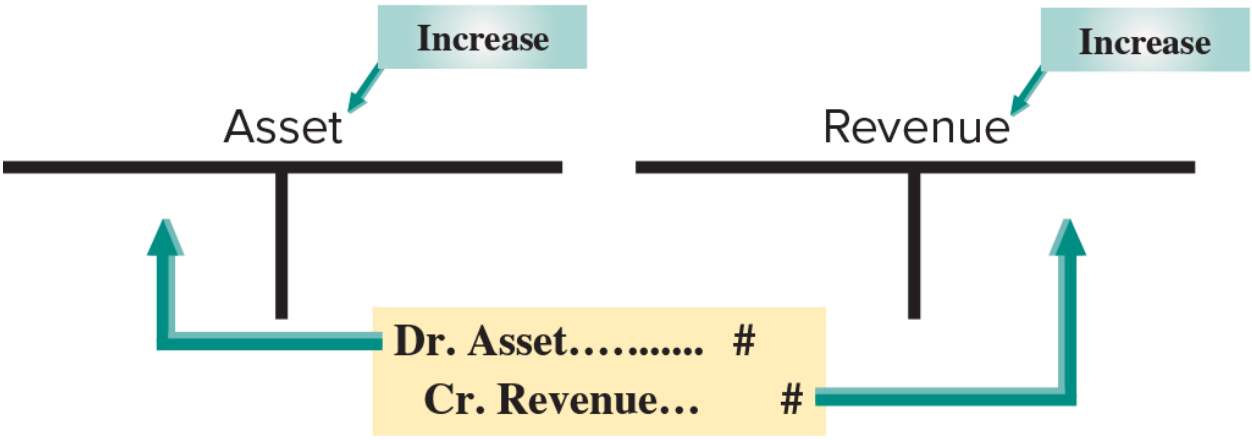
Consulting Revenue 403

		Dec. 5	4,200
		12	1,600
		31	250
		31	1,800
		Balance	7,850

Accrued Revenues

Dec. 31 Record revenue and receivable for services provided but unbilled

Jan. 10 Receive cash and reduce receivable



TRIAL BALANCE AND FINANCIAL STATEMENTS Adjusted Trial Balance P5 Prepare financial statements from an adjusted trial balance. An unadjusted trial balance is a list of accounts and balances before adjustments are recorded. An adjusted trial balance is a list of accounts and balances after adjusting entries have been recorded and posted to the ledger. Exhibit 3.13 shows both the unadjusted and the adjusted trial balances for FastForward at December 31, 2021. The order of accounts in the trial balance usually matches the order in the chart of accounts. Several new accounts usually arise from adjusting entries. EXHIBIT 3.13 Unadjusted and Adjusted Trial Balances Each adjustment (see middle columns) has a letter that links it to an adjusting entry explained earlier. Each amount in the Adjusted Trial Balance columns is computed by taking that account's amount from the Unadjusted Trial Balance columns and adding or subtracting any adjustment(s). To demonstrate, Supplies has a $9,720 Dr. balance in the unadjusted columns. Subtracting the $1,050 Cr. amount shown in the Adjustments columns equals an adjusted $8,670 Dr. balance for Supplies. An account can have more than one adjustment, such as for Consulting Revenue. Also, some accounts might not require adjustment for this period, such as Accounts Payable. Page 98 Preparing Financial Statements We can prepare financial statements directly from information in the adjusted trial balance. Exhibit 3.14 shows how revenue and expense balances are transferred from the adjusted trial balance to the income statement (red lines). The net income and withdrawals amounts are then used to prepare the statement of owner's equity (brown lines). Asset and liability balances are then transferred to the balance sheet (blue lines). The ending capital is computed in the statement of owner's equity and transferred to the balance sheet (green line). EXHIBIT 3.14 Preparing Financial Statements Page 99 We prepare financial statements in the following order: (1) income statement, (2) statement of owner's equity, and (3) balance sheet. This order makes sense because the balance sheet uses information from the statement of owner's equity, which in turn uses information from the income statement. The statement of cash flows is usually the final statement prepared. Point: Each trial balance amount is used in only one financial statement. NEED-TO-KNOW 3-5 Preparing Financial Statements from a Trial Balance P5 Use the following adjusted trial balance of Magic Company to prepare its December 31 year-end (1) income statement, (2) statement of owner's equity, and (3) balance sheet (unclassified). The Magic, Capital account balance was $75,000 on December 31 of the prior year. Do More: QS 3-18, QS 3-19, E 3-15, E 3-16, E 3-17, P 3-4

MAGIC COMPANY
Adjusted Trial Balance
December 31

Account Title	Debit	Credit
Cash	$ 13,000	
Accounts receivable	17,000	
Land	85,000	
Accounts payable		$ 12,000
Long-term notes payable		33,000
Magic, Capital		75,000
Magic, Withdrawals	20,000	
Services revenue		79,000
Salaries expense	56,000	
Supplies expense	8,000	
Totals	$199,000	$199,000

Solution

Step 1

MAGIC COMPANY
Income Statement
For Year Ended December 31

Revenues		
Services revenue		$79,000
Expenses		
Salaries expense	$56,000	
Supplies expense	8,000	
Total expenses		64,000
Net income		$15,000

Step 2

MAGIC COMPANY
Statement of Owner's Equity
For Year Ended December 31

Magic, Capital, December 31, prior year-end	$75,000
Add: Investments by owner	0
Net income	15,000
	90,000
Less: Withdrawals by owner	20,000
Magic, Capital, December 31 current year-end	$70,000

Step 3

MAGIC COMPANY
Balance Sheet
December 31

Assets	
Cash	$ 13,000
Accounts receivable	17,000
Land	85,000
Total assets	$115,000
Liabilities	
Accounts payable	$ 12,000
Long-term notes payable	33,000
Total liabilities	45,000
Equity	
Magic, Capital	70,000
Total liabilities and equity	$115,000

FASTFORWARD
Trial Balances
December 31, 2021

Acct. No.	Account Title	Unadjusted Trial Balance Dr.	Unadjusted Trial Balance Cr.	Adjustments Dr.	Adjustments Cr.	Adjusted Trial Balance Dr.	Adjusted Trial Balance Cr.
101	Cash	$ 4,275				$ 4,275	
106	Accounts receivable	0		(f) $1,800		1,800	
126	Supplies	9,720			(b) $1,050	8,670	
128	Prepaid insurance	2,400			(a) 100	2,300	
167	Equipment	26,000				26,000	
168	Accumulated depreciation—Equip.		$ 0		(c) 300		$ 300
201	Accounts payable		6,200				6,200
209	Salaries payable		0		(e) 210		210
236	Unearned consulting revenue		3,000	(d) 250			2,750
301	C. Taylor, Capital		30,000				30,000
302	C. Taylor, Withdrawals	200				200	
403	Consulting revenue		5,800		(d) 250		7,850
					(f) 1,800		
406	Rental revenue		300				300
612	Depreciation expense—Equip.	0		(c) 300		300	
622	Salaries expense	1,400		(e) 210		1,610	
637	Insurance expense	0		(a) 100		100	
640	Rent expense	1,000				1,000	
652	Supplies expense	0		(b) 1,050		1,050	
690	Utilities expense	305				305	
	Totals	$45,300	$45,300	$3,710	$3,710	$47,610	$47,610

Page 100 Decision Analysis Profit Margin A1 Compute and analyze profit margin. A useful measure of a company's operating results is the ratio of its net income to net sales. This ratio is called profit margin, or return on sales, and is computed as in Exhibit 3.15. This ratio shows the percent of profit in each dollar of sales. EXHIBIT 3.15 Profit Margin Visa's profit margins are shown in Exhibit 3.16. Visa's profit margin is superior to Mastercard's in each of the last three years. For Mastercard to improve its profit margin, it must either reduce expenses or increase revenues at a relatively greater amount than expenses. EXHIBIT 3.16 Computation and Analysis Using Profit Margin. Company Figure ($ millions) Current Year 1 Year Ago 2 Years Ago Visa Net income $12,080 $10,301 $ 6,699 Net sales $22,977 $20,609 $18,358 Profit margin 53% 50% 36% Mastercard Profit margin 48% 39% 31% Decision Maker CFO Your health care equipment company consistently reports a 9% profit margin, which is similar to that of competitors. The treasurer argues that profit margin can be increased to 20% if the company cuts marketing expenses. Do you cut those expenses? ■ Answer

Page 102 NEED-TO-KNOW 3-7 COMPREHENSIVE 2 Preparing Financial Statements from Adjusted Account Balances Use the following year-end adjusted trial balance to answer questions 1–3. Table Summary: A statement providing the adjusted trial balance appears with a three-line title, column headings for debits and credits, and a listing of accounts. First four rows of accounts have a debit entry; the next five rows have a credit entry; the next row for withdrawals is a debit entry, followed by a row with a credit entry for Rent earned. The remaining rows have debit entries, including that last row for totals, which has both a debit and a credit entry. CHOI COMPANY Adjusted Trial Balance December 31 Debit Credit Cash $ 3,050 Accounts receivable 400 Prepaid insurance 910 Equipment 217,200 Accumulated depreciation—Equipment $ 29,100 Interest payable 4,480 Unearned revenue 460 Long-term notes payable 150,000 M. Choi, Capital 40,340 M. Choi, Withdrawals 21,000 Services revenue 57,500 Wages expense 25,000 Utilities expense 1,900 Insurance expense 3,450 Depreciation expense—Equipment 5,970 Interest expense 3,000 Totals $281,880 $281,880 Prepare the annual income statement from the adjusted trial balance of Choi Company. Answer follows: Table Summary: The income statement is headed by a three-line title. One entry under Revenues contains an entry in the far right column. Five entries under Expenses contain entries indented to the left of the far right column. The Total Expenses line amount is underlined and situated at the far right. The Net Income line is double-underlined at the far right. CHOI COMPANY Income Statement For Year Ended December 31 Revenues Services revenue $57,500 Expenses Wages expense $25,000 Utilities expense 1,900 Insurance expense 3,450 Depreciation expense—Equipment 5,970 Interest expense 3,000 Total expenses 39,320 Net income $18,180 Prepare a statement of owner’s equity from the adjusted trial balance of Choi Company. The beginning-year capital balance was $30,340, and the owner invested $10,000 in the company in the current year. Answer follows: Table Summary: The statement of owner's equity is headed by a three-line title. Beginning capital is listed on the first line with an entry in the far right column. Investments and net income are listed, summed, and added. Withdrawals are subtracted, leaving year-end Capital balance. CHOI COMPANY Statement of Owner’s Equity For Year Ended December 31 M. Choi, Capital, December 31, prior year-end $30,340 Plus: Investments by owner $10,000 Net income 18,180 28,180 58,520 Less: Withdrawals by owner 21,000 M. Choi, Capital, December 31, current year-end $37,520 Prepare a balance sheet (unclassified) from the adjusted trial balance of Choi Company. Answer follows: Table Summary: The balance sheet is headed by a three-line title. Under centered headings for Asset, Liabilities, and Equity, the specific accounts are listed and totaled. CHOI COMPANY Balance Sheet December 31 Assets Cash $ 3,050 Accounts receivable 400 Prepaid insurance 910 Equipment $217,200 Less accumulated depreciation 29,100 188,100 Total assets $192,460 Liabilities Interest

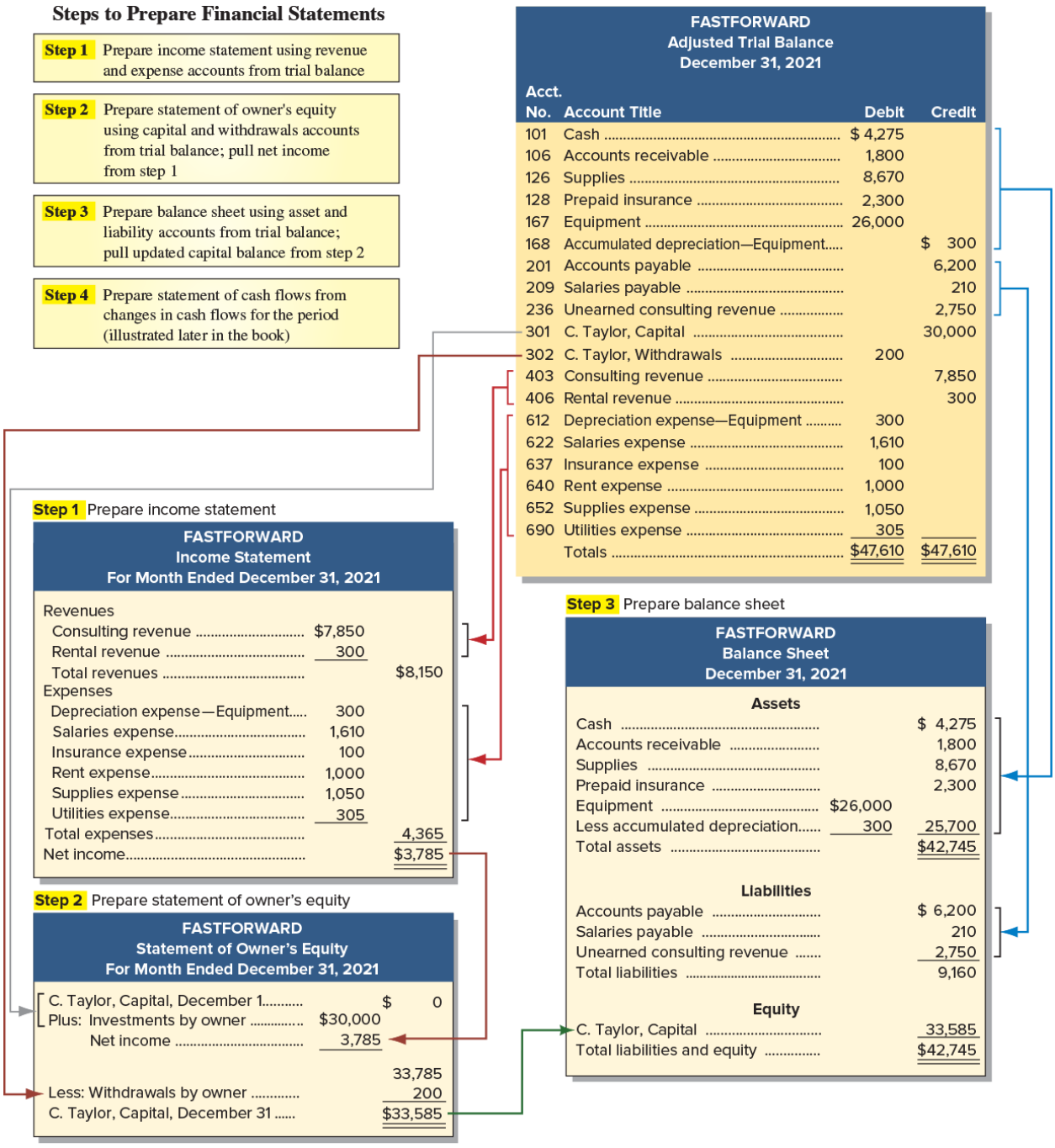
payable $ 4,480 Unearned revenue 460 Long-term notes payable 150,000 Total liabilities 154,940 Equity M. Choi, Capital 37,520 Total liabilities and equity $192,460

Page 103 APPENDIX 3A: Alternative Accounting for Prepayments P6 Explain the alternatives in accounting for prepaids. This appendix explains alternative accounting for deferred expenses and deferred revenues. RECORDING PREPAYMENT OF EXPENSES IN EXPENSE ACCOUNTS An alternative method is to record all prepaid expenses with debits to expense accounts. If any prepaids remain unused or unexpired at the end of an accounting period, then adjusting entries transfer the cost of the unused portions from expense accounts to prepaid expense (asset) accounts. The financial statements are identical under either method, but the adjusting entries are different. To demonstrate the differences between these two methods, let's look at FastForward's cash payment on December 1 for 24 months of insurance coverage beginning on December 1. FastForward recorded that payment with a debit to an asset account, but it could have recorded a debit to an expense account. These alternatives are shown in Exhibit 3A.1. EXHIBIT 3A.1 Alternative Initial Entries for Prepaid Expenses Table Summary: Two side-by-side journal entries with date, accounts debited and credited, and amounts are identified by a heading. Payment Recorded as Asset Dec. 1 Prepaid Insurance 2,400 Cash 2,400 Payment Recorded as Expense Dec. 1 Insurance Expense 2,400 Cash 2,400 At the end of its accounting period on December 31, insurance protection for one month has expired. This means $100 ($2,400/24) of insurance coverage expired and is an expense for December. The adjusting entry depends on how the original payment was recorded. This is shown in Exhibit 3A.2. EXHIBIT 3A.2 Adjusting Entry for Prepaid Expenses for the Two Alternatives Table Summary: Two side-by-side journal entries with date, accounts debited and credited, and amounts are identified by a heading. Payment Recorded as Asset Dec. 31 Insurance Expense 100 Prepaid Insurance 100 Payment Recorded as Expense Dec. 31 Prepaid Insurance 2,300 Insurance Expense 2,300 When the entries are posted, we see in Exhibit 3A.3 that the two methods give identical ending balances. EXHIBIT 3A.3 Account Balances under Two Alternatives for Recording Prepaid Expenses Table Summary: Left side of table are two T-accounts. Top account has one debit entry, one credit entry, and a debit balance. Bottom account has one debit entry. Right side of table are two T-accounts. Top account has one debit entry. Bottom account has one debit entry, one credit entry, and a debit balance. Payment Recorded as Asset Prepaid Insurance 128 Dec. 1 2,400 Dec. 31 100 Balance 2,300 Insurance Expense 637 Dec. 31 100 Payment Recorded as Expense Prepaid Insurance 128 Dec. 31 2,300 Insurance Expense 637 Dec. 1 2,400 Dec. 31 2,300 Balance 100 RECORDING PREPAYMENT OF REVENUES IN REVENUE ACCOUNTS An alternative method is to record all unearned

revenues with credits to revenue accounts. If any revenues are unearned at the end of an accounting period, then adjusting entries transfer the unearned portions from revenue accounts to unearned revenue (liability) accounts. The adjusting entries are different for these two alternatives, but the financial statements are identical. To demonstrate the differences between these two methods, let's look at FastForward's December 26 receipt of $3,000 for consulting services covering the period December 27 to February 24. FastForward recorded this transaction with a credit to a liability account. The alternative is to record it with a credit to a revenue account, as shown in Exhibit 3A.4. EXHIBIT 3A.4 Alternative Initial Entries for Unearned Revenues Table Summary: Two side-by-side journal entries with date, accounts debited and credited, and amounts are identified by a heading. Receipt Recorded as Liability Dec. 26 Cash 3,000 Unearned Consulting Revenue 3,000 Receipt Recorded as Revenue Dec. 26 Cash 3,000 Consulting Revenue 3,000Page 104 By the end of its accounting period on December 31, FastForward has earned $250 of this revenue. This means $250 of the liability has been satisfied. Depending on how the initial receipt is recorded, the adjusting entry is as shown in Exhibit 3A.5. EXHIBIT 3A.5 Adjusting Entry for Unearned Revenues for the Two Alternatives Table Summary: Two side-by-side journal entries with date, accounts debited and credited, and amounts are identified by a heading. Receipt Recorded as Liability Dec. 31 Unearned Consulting Revenue 250 Consulting Revenue 250 Receipt Recorded as Revenue Dec. 31 Consulting Revenue 2,750 Unearned Consulting Revenue 2,750 After entries are posted, the two alternatives give identical ending balances, as shown in Exhibit 3A.6. EXHIBIT 3A.6 Account Balances under Two Alternatives for Recording Unearned Revenues Table Summary: Left side of table are two T-accounts. Top account has one debit entry, one credit entry, and a debit balance. Bottom account has one credit entry. Right side of table are two T-accounts. Top account has one debit entry. Bottom account has one debit entry, one credit entry, and a credit balance. Receipt Recorded as Liability Unearned Consulting Revenue 236 Dec. 31 250 Dec. 26 3,000 Balance 2,750 Consulting Revenue 403 Dec. 31 250 Receipt Recorded as Revenue Unearned Consulting Revenue 236 Dec. 31 2,750 Consulting Revenue 403 Dec. 31 2,750 Dec. 26 3,000 Balance 250

Summary: Cheat Sheet DEFERRAL OF EXPENSE Prepaid expenses: Assets paid for in advance of receiving their benefits. When these assets are used, the advance payments become expenses. Prepaid insurance expires: Table Summary: Three transactions are identified and then presented as journal entries with debit account and amount and indented credit account and amount. Insurance Expense 100 Prepaid Insurance 100 Supplies are used up: Supplies Expense 1,050 Supplies 1,050 Accumulated

depreciation: A separate contra account. A contra account is an account linked with another account. It has an opposite normal balance and is a subtraction from that other account's balance. Depreciation of assets: Depreciation Expense 300 Accumulated Depreciation—Equipment 300 DEFERRAL OF REVENUE Unearned revenue: Cash received in advance of providing products and services. When cash is accepted, the company has a liability to provide products or services. Record unearned revenue (cash received in advance): Table Summary: Two transactions are identified and then presented as journal entries with debit account and amount and indented credit account and amount. Cash 3,000 Unearned Consulting Revenue 3,000 Reduce unearned revenue (products or services are provided): Unearned Consulting Revenue 250 Consulting Revenue 250 ACCRUED EXPENSE Accrued expenses: Costs incurred in a period that are both unpaid and unrecorded. They are reported on the income statement for the period when incurred. Salaries expense owed but not yet paid: Table Summary: One transaction is identified and then presented as a journal entry with debit account and amount and indented credit account and amount. Salaries Expense 210 Salaries Payable 210 Accrued interest formula: Principal amount owed × Annual interest rate × Fraction of year since last payment Payment of accrued expenses: Table Summary: One transaction is identified and then presented as a journal entry with two debit accounts and amounts and one credit account and amount. Salaries Payable (3 days at $70 per day) 210 Salaries Expense (7 days at $70 per day) 490 Cash 700Page 105 ACCRUED REVENUE Accrued revenues: Revenues earned in a period that are both unrecorded and not yet received in cash. Revenue earned but not received in cash: Table Summary: Two transactions are identified and then presented as journal entries: the first with debit account and amount and indented credit account and amount, and the second with a debit account and amount and two indented credit accounts and amounts. Accounts Receivable 1,800 Consulting Revenue 1,800 Receipt of accrued revenue: Cash 2,700 Accounts Receivable (20 days at $90 per day) 1,800 Consulting Revenue (10 days at $90 per day) 900 REPORTING AND ANALYSIS Unadjusted trial balance: A list of ledger accounts and balances before adjustments are recorded. Adjusted trial balance: A list of accounts and balances after adjusting entries have been recorded and posted to the ledger. Preparing financial statements from adjusted trial balance:


Steps to Prepare Financial Statements
Step 1 Prepare income statement using revenue and expense accounts from trial balance
Step 2 Prepare statement of owner's equity using capital and withdrawals accounts from trial balance; pull net income from step 1
Step 3 Prepare balance sheet using asset and liability accounts from trial balance; pull updated capital balance from step 2
Step 4 Prepare statement of cash flows from changes in cash flows for the period (illustrated later in the book)
FASTFORWARD
Adjusted Trial Balance
December 31, 2021
Acct. No. Account Title Debit Credit
101 Cash $ 4,275
106 Accounts receivable 1,800
126 Supplies 8,670
128 Prepaid insurance 2,300
167 Equipment 26,000
168 Accumulated depreciation—Equipment $ 300
201 Accounts payable 6,200
209 Salaries payable 210
236 Unearned consulting revenue 2,750
301 C. Taylor, Capital 30,000
302 C. Taylor, Withdrawals 200
403 Consulting revenue 7,850
406 Rental revenue 300
612 Depreciation expense—Equipment 300
622 Salaries expense 1,610
637 Insurance expense 100
640 Rent expense 1,000
652 Supplies expense 1,050
690 Utilities expense 305
Totals $47,610 $47,610
Step 1 Prepare income statement
FASTFORWARD
Income Statement
For Month Ended December 31, 2021
Revenues
Consulting revenue $7,850
Rental revenue 300
Total revenues $8,150
Expenses
Depreciation expense—Equipment 300
Salaries expense 1,610
Insurance expense 100
Rent expense 1,000
Supplies expense 1,050
Utilities expense 305
Total expenses 4,365
Net income $3,785
Step 2 Prepare statement of owner's equity
FASTFORWARD
Statement of Owner's Equity
For Month Ended December 31, 2021
C. Taylor, Capital, December 1 $ 0
Plus: Investments by owner $30,000
Net income 3,785
33,785
Less: Withdrawals by owner 200
C. Taylor, Capital, December 31 $33,585
Step 3 Prepare balance sheet
FASTFORWARD
Balance Sheet
December 31, 2021
Assets
Cash $ 4,275
Accounts receivable 1,800
Supplies 8,670
Prepaid insurance 2,300
Equipment $26,000
Less accumulated depreciation 300 25,700
Total assets $42,745
Liabilities
Accounts payable $ 6,200
Salaries payable 210
Unearned consulting revenue 2,750
Total liabilities 9,160
Equity
C. Taylor, Capital 33,585
Total liabilities and equity $42,745

Key Terms Accounting period (85) Accrual basis accounting (86) Accrued expenses (95) Accrued revenues (94) Accumulated depreciation (89) Adjusted trial balance (97) Adjusting entry (87) Annual financial statements (85) Book value (89) Cash basis accounting (86) Contra account (89) Depreciation (89) Expense recognition (or matching) principle (86) Fiscal year (85) Interim financial statements (85) Natural business year (85) Plant assets (88) Prepaid expenses (87) Profit margin (100) Revenue recognition principle (86) Straight-

line depreciation (89) Time period assumption (85) Unadjusted trial balance (97) Unearned revenue (91)

Page 105 Multiple Choice Quiz A company forgot to record accrued and unpaid employee wages of $350,000 at period-end. This oversight would Understate net income by $350,000. Overstate net income by $350,000. Have no effect on net income. Overstate assets by $350,000. Understate assets by $350,000. Prior to recording adjusting entries, the Supplies account has a $450 debit balance. A physical count of supplies shows $125 of unused supplies still available. The required adjusting entry is Debit Supplies $125; credit Supplies Expense $125. Debit Supplies $325; credit Supplies Expense $325. Debit Supplies Expense $325; credit Supplies $325. Debit Supplies Expense $325; credit Supplies $125. Debit Supplies Expense $125; credit Supplies $125. On May 1 of the current year, a two-year insurance policy was purchased for $24,000 with coverage to begin immediately. What is the amount of insurance expense that appears on the company's income statement for the current year ended December 31? $4,000 $8,000 $12,000 $20,000 $24,000 On November 1, Stockton Co. receives $3,600 cash from Hans Co. for consulting services to be provided evenly over the period November 1 to April 30—at which time Stockton credits $3,600 to Unearned Revenue. The adjusting entry on December 31 (Stockton's year-end) would include aPage 106 Debit to Unearned Revenue for $1,200. Debit to Unearned Revenue for $2,400. Credit to Consulting Revenue for $2,400. Debit to Consulting Revenue for $1,200. Credit to Cash for $3,600. If a company had $15,000 in net income for the year, and its sales were $300,000 for the same year, what is its profit margin? 20% 2,000% $285,000 $315,000 5% ANSWERS TO MULTIPLE CHOICE QUIZ b; the forgotten adjusting entry is: dr. Wages Expense, cr. Wages Payable. c; Supplies used b; Insurance expense adjusting entry is: dr. Insurance Expense for $8,000, cr. Prepaid Insurance for $8,000. a; Consulting Revenue earned adjusting entry is: dr. Unearned Revenue for $1,200, cr. Consulting Revenue for $1,200. e; Profit margin

QUICK STUDY Select Quick Study and Exercise assignments feature Guided Example videos, called "Hints" in Connect. Hints use different numbers, and instructors can turn this feature on or off. Superscript letter A denotes assignments based on Appendix 3A. QS 3-1 Periodic reporting C1 Choose from the following list of terms and phrases to best complete the statements below. Fiscal year Timeliness Accrual basis accounting Annual financial statements Cash basis accounting Time period assumption presumes that an organization's activities can be divided into specific time periods. Financial reports covering a one-year period are known as . A(n) consists of any 12 consecutive months.

records revenues when services are provided and records expenses when incurred. The value of information is often linked to its . QS 3-2 Computing accrual and cash income C1 In its first year of operations, Roma Company reports the following. Compute Roma's first-year net income under the cash basis and the accrual basis of accounting. Earned revenues of $45,000 ($37,000 cash received from customers). Incurred expenses of $25,500 ($20,250 cash paid toward them). Prepaid $6,750 cash for costs that will not be expensed until next year. QS 3-3 Identifying accounting adjustments P1 P2 P3 P4 Classify the following adjusting entries as involving prepaid expenses, unearned revenues, accrued expenses, or accrued revenues. To record revenue earned that was previously received as cash in advance. To record wages expense incurred but not yet paid or recorded. To record revenue earned but not yet billed or recorded. To record expiration of prepaid insurance. To record annual depreciation expense. QS 3-4 Concepts of adjusting entries P1 P2 P3 P4 At the end of its annual accounting period, the company must make three adjusting entries. For each of these adjusting entries, indicate the account to be debited and the account to be credited. Accrue salaries expense. Adjust the Unearned Revenue account to recognize earned services revenue. Record services revenue earned for which cash will be received the following period. QS 3-5 Prepaid (deferred) expenses adjustments P1 For each separate case below, follow the three-step process for adjusting the prepaid asset account at December 31. Step 1: Determine what the current account balance equals. Step 2: Determine what the current account balance should equal. Step 3: Record the December 31 adjusting entry to get from step 1 to step 2. Assume no other adjusting entries are made during the year. Prepaid Insurance. The Prepaid Insurance account has a $4,700 debit balance to start the year. A review of insurance policies shows that $900 of unexpired insurance remains at year-end.Page 107 Prepaid Insurance. The Prepaid Insurance account has a $5,890 debit balance at the start of the year. A review of insurance policies shows $1,040 of insurance has expired by year-end. Prepaid Rent. On September 1 of the current year, the company prepaid $24,000 for two years of rent for facilities being occupied that day. The company debited Prepaid Rent and credited Cash for $24,000. QS 3-6 Prepaid (deferred) expenses adjustments P1 For each separate case below, follow the three-step process for adjusting the Supplies asset account at December 31. Step 1: Determine what the current account balance equals. Step 2: Determine what the current account balance should equal. Step 3: Record the December 31 adjusting entry to get from step 1 to step 2. Assume no other adjusting entries are made during the year. Supplies. The Supplies account has a $300 debit balance to start the year. No supplies were purchased during the current year. A December 31 physical count shows $110 of supplies remaining. Supplies. The Supplies account has an $800 debit balance to start the year. Supplies of $2,100 were purchased during the current year and debited to the Supplies account. A December 31 physical count shows $650 of supplies remaining. Supplies. The Supplies account has a

$4,000 debit balance to start the year. During the current year, supplies of $9,400 were purchased and debited to the Supplies account. The inventory of supplies available at December 31 totaled $2,660. QS 3-7 Adjusting prepaid (deferred) expenses P1 For each separate case, record the necessary adjusting entry. On July 1, Lopez Company paid $1,200 for six months of insurance coverage. No adjustments have been made to the Prepaid Insurance account, and it is now December 31. Prepare the year-end adjusting entry to reflect expiration of the insurance as of December 31. Zim Company has a Supplies account balance of $5,000 at the beginning of the year. During the year, it purchases $2,000 of supplies. As of December 31, a physical count of supplies shows $800 of supplies available. Prepare the adjusting journal entry to correctly report the balance of the Supplies account and the Supplies Expense account as of December 31. QS 3-8 Accumulated depreciation calculations and adjustments P1 For each separate case below, follow the three-step process for adjusting the Accumulated Depreciation account at December 31. Step 1: Determine what the current account balance equals. Step 2: Determine what the current account balance should equal. Step 3: Record the December 31 adjusting entry to get from step 1 to step 2. Assume no other adjusting entries are made during the year. Accumulated Depreciation. The Krug Company's Accumulated Depreciation account has a $13,500 balance to start the year. A review of depreciation schedules reveals that $14,600 of depreciation expense must be recorded for the year. Accumulated Depreciation. The company has only one plant asset (truck) that it purchased at the start of this year. That asset had cost $44,000, had an estimated life of five years, and is expected to have zero value at the end of the five years. Accumulated Depreciation. The company has only one plant asset (equipment) that it purchased at the start of this year. That asset had cost $32,000, had an estimated life of seven years, and is expected to be valued at $4,000 at the end of the seven years. QS 3-9 Adjusting for depreciation P1 For each separate case, record an adjusting entry (if necessary). Barga Company purchases $20,000 of equipment on January 1. The equipment is expected to last five years and be worth $2,000 at the end of that time. Prepare the entry to record one year's depreciation expense of $3,600 for the equipment as of December 31. Welch Company purchases $10,000 of land on January 1. The land is expected to last forever. What depreciation adjustment, if any, should be made with respect to the Land account as of December 31? QS 3-10 Unearned (deferred) revenues adjustments P2 For each separate case below, follow the three-step process for adjusting the unearned revenue liability account at December 31. Step 1: Determine what the current account balance equals. Step 2: Determine what the current account balance should equal. Step 3: Record the December 31 adjusting entry to get from step 1 to step 2. Assume no other adjusting entries are made during the year. Unearned Rent Revenue. The Krug Company collected $6,000 rent in advance on November 1, debiting Cash and crediting Unearned Rent Revenue. The tenant

was paying 12 months' rent in advance and occupancy began November 1.Page 108 Unearned Services Revenue. The company charges $75 per insect treatment. A customer paid $300 on October 1 in advance for four treatments, which was recorded with a debit to Cash and a credit to Unearned Services Revenue. At year-end, the company has applied three treatments for the customer. Unearned Rent Revenue. On September 1, a client paid the company $24,000 cash for six months of rent in advance and took occupancy immediately. The company recorded the cash as Unearned Rent Revenue. QS 3-11 Adjusting for unearned (deferred) revenues P2 For each separate case, record the necessary adjusting entry. Tao Co. receives $10,000 cash in advance for four months of evenly planned legal services beginning on October 1. Tao records it by debiting Cash and crediting Unearned Revenue both for $10,000. It is now December 31, and Tao has provided legal services as planned. What adjusting entry should Tao make to account for the work performed from October 1 through December 31? Caden started a new publication called Contest News. Its subscribers pay $24 to receive 12 monthly issues. With every new subscriber, Caden debits Cash and credits Unearned Subscription Revenue for the amounts received. The company has 100 new subscribers as of July 1. It sends Contest News to each of these subscribers every month from July through December. Assuming no changes in subscribers, prepare the year-end journal entry that Caden must make as of December 31 to adjust the Subscription Revenue account and the Unearned Subscription Revenue account. QS 3-12 Adjusting for unearned (deferred) revenues P2 For each separate case, record an adjusting entry (if necessary). Lonzo Co. receives $3,000 cash in advance for six months of recycling services on September 1 and records it by debiting Cash and crediting Unearned Revenue for $3,000. Lonzo provides recycling services monthly as promised. Prepare the December 31 year-end adjusting entry that Lonzo records for the work performed from September 1 through December 31. On October 20, Milwaukee Bucks sold a 10-game ticket package for $200 and recorded Unearned Revenue. By December 31, 4 of the 10 games had been played. Record the December 31 year-end adjusting entry that the Bucks record for the 40% of revenue earned on the $200 ticket package. QS 3-13 Accrued expenses adjustments P3 For each separate case below, follow the three-step process for adjusting the accrued expense account at December 31. Step 1: Determine what the current account balance equals. Step 2: Determine what the current account balance should equal. Step 3: Record the December 31 adjusting entry to get from step 1 to step 2. Assume no other adjusting entries are made during the year. Salaries Payable. At year-end, salaries expense of $15,500 has been incurred by the company but is not yet paid to employees. Interest Payable. At its December 31 year-end, the company owes $250 of interest on a loan. That interest will not be paid until sometime in January of the next year. Interest Payable. At its December 31 year-end, the company holds a mortgage payable that has incurred $875 in annual interest

that is neither recorded nor paid. The company intends to pay the interest on January 7 of the next year. QS 3-14 Accruing salaries P3 Molly Mocha employs one college student every summer in her coffee shop. The student works the five weekdays and is paid on the following Monday. (For example, a student who works Monday through Friday, June 1 through June 5, is paid for that work on Monday, June 8.) The coffee shop makes an adjusting entry each month to show salaries earned but unpaid at month-end. The student works the last week of July, which is Monday, July 28, through Friday, August 1. If the student earns $100 per day, what adjusting entry must the coffee shop make on July 31 to correctly record accrued salaries expense for July? QS 3-15 Accrued revenues adjustments P4 For each separate case below, follow the three-step process for adjusting the accrued revenue account at December 31. Step 1: Determine what the current account balance equals. Step 2: Determine what the current account balance should equal. Step 3: Record the December 31 adjusting entry to get from step 1 to step 2. Assume no other adjusting entries are made during the year. Accounts Receivable. At year-end, the L. Cole Company has completed services of $19,000 for a client, but the client has not yet been billed for those services.Page 109 Interest Receivable. At year-end, the company has earned, but not yet recorded, $390 of interest earned from its investments in government bonds. Accounts Receivable. A painting company bills customers when jobs are complete. The work for one job is now complete. The customer has not yet been billed for the $1,300 of work. QS 3-16 Recording and analyzing adjusting entries P1 P2 P3 P4 For the entries below, identify the account to be debited and the account to be credited. Indicate which of the accounts is the income statement account and which is the balance sheet account. Entry to record services revenue earned that was previously received as cash in advance. Entry to record wage expenses incurred but not yet paid or recorded. Entry to record services revenue earned but not yet billed or recorded. Entry to record expiration of prepaid insurance. Entry to record annual depreciation expense. QS 3-17 Determining effects of adjusting entries P1 P3 In making adjusting entries at the end of its accounting period, Chao Consulting mistakenly forgot to record: $3,200 of insurance coverage that had expired (this $3,200 cost had been initially debited to the Prepaid Insurance account). $2,000 of accrued salaries expense. As a result of these two oversights, the financial statements for the reporting period will [choose one]: Understate assets by $3,200. Understate expenses by $5,200. Understate net income by $2,000. Overstate liabilities by $2,000. QS 3-18 Preparing an adjusted trial balance P5 Following are unadjusted balances along with year-end adjustments for Quinlan Company. Complete the adjusted trial balance by entering the adjusted balance for each of the following accounts. QS 3-19 Preparing financial statements P5 The adjusted trial balance for Happ Company follows. Use the adjusted trial balance to prepare the December 31 year-end (a) income statement, (b) statement of owner's equity, and (c) balance sheet. The E. Happ, Capital account balance was $65,500

on December 31 of the prior year, and there were no owner investments in the current year. Check Net income, $17,800 Page 110 QS 3-20 Computing and analyzing profit margin A1 Gomez Company reported net income of $48,025 and net sales of $425,000 for the current year. (a) Compute Gomez's profit margin. (b) Assuming Cruz (a competitor) has a profit margin of 15%, which company is generating more profit on each dollar of sales? QS 3-21A Preparing adjusting entries P6 Garcia Company had the following selected transactions during the year. Jan. 1 The company paid $6,000 cash for 12 months of insurance coverage beginning immediately. Aug. 1 The company received $2,400 cash in advance for 6 months of contracted services beginning on August 1 and ending on January 31. Dec. 31 The company prepared any necessary year-end adjusting entries related to insurance coverage and services performed. Record journal entries for these transactions assuming Garcia follows the usual practice of recording a prepayment of an expense in an asset account and recording a prepayment of revenue received in a liability account. Record journal entries for these transactions assuming Garcia follows the alternative practice of recording a prepayment of an expense in an expense account and recording a prepayment of revenue received in a revenue account. QS 3-22A Preparing adjusting entries P6 Cal Consulting follows the practice that prepayments are debited to expense when paid, and unearned revenues are credited to revenue when cash is received. Given this company's accounting practices, which one of the following applies to the preparation of adjusting entries at the end of its first accounting period? Unearned revenue (on which cash was received in advance earlier in the period) is recorded with a debit to Consulting Revenue of $500 and a credit to Unearned Revenue of $500. Unpaid salaries of $400 are recorded with a debit to Prepaid Salaries of $400 and a credit to Salaries Expense of $400. Office supplies purchased for the period were $1,000. The cost of unused office supplies of $650 is recorded with a debit to Supplies Expense of $650 and a credit to Office Supplies of $650. Earned but unbilled (and unrecorded) consulting revenue for the period was $1,200, which is recorded with a debit to Unearned Revenue of $1,200 and a credit to Consulting Revenue

of $1,200.

Adjusted Trial Balance December 31		
Account Title	**Dr.**	**Cr.**
Cash	$ 7,000	
Accounts receivable	27,200	
Trucks	42,000	
Accumulated depreciation—Trucks		$ 17,500
Land	32,000	
Accounts payable		15,000
Salaries payable		4,200
Unearned revenue		3,600
E. Happ, Capital		65,500
E. Happ, Withdrawals	15,400	
Plumbing revenue		84,000
Depreciation expense—Trucks	6,500	
Salaries expense	46,700	
Rent expense	13,000	
Totals	$189,800	$189,800

		Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
No.	**Account Title**	**Dr.**	**Cr.**	**Dr.**	**Cr.**	**Dr.**	**Cr.**
101	Cash	$8,000					
106	Accounts receivable	2,000		$4,000			
126	Supplies	4,500			$2,500		
209	Salaries payable		$ 0		400		
301	J, Quinlan, Capital		9,000				
403	Consulting revenue		11,000		4,000		
622	Salaries expense	5,500		400			
652	Supplies expense	0		2,500			

EXERCISES Exercise 3-1 Determining assets and expenses for accrual and cash accounting C1 On March 1, Year 1, a company paid an $18,000 premium on a 36-month insurance policy for coverage beginning on that date. Refer to that policy and fill in the blanks in the following table. Table Summary: Banner headings appear over columns 1 through 3 and over 4 through 6. Columns 2, 3, 5, and 6 have subheadings. Columns 2, 3, 5, and 6 also

have blank lines where dollar amounts can be inserted. Balance Sheet: Prepaid Insurance Income Statement: Insurance Expense Accrual Basis Cash Basis Accrual Basis Cash Basis Dec. 31, Year 1 $_____ $_____ Year 1 $_____ $_____ Dec. 31, Year 2 _____ _____ Year 2 _____ _____ Dec. 31, Year 3 _____ _____ Year 3 _____ _____ Dec. 31, Year 4 _____ _____ Year 4 _____ _____ Total $ $ Exercise 3-2 Determining when to recognize revenue C1 For each of the following separate situations, determine how much revenue is recognized in December (using accrual basis accounting). On December 7, Oklahoma City Thunder sold a $90 ticket to a basketball game to be played in March. Tesla sold and delivered a $58,000 car on December 25. The customer will not pay until February. Deloitte signs a contract on December 1 to provide 40 days of advisory services with receipt of $10,000 due at the end of the contract. On December 31, 75% of the services have been completed. Exercise 3-3 Determining when to recognize expenses C1 For each of the following separate situations, determine the amount of expense each company should recognize in December (using accrual basis accounting). Chipotle has monthly wages expense of $3,200 that has been incurred but not paid as of December 31. United Airlines purchases a 24-month insurance policy for $48,000 on December 1 for immediate coverage. On December 15, Pfizer prepays $20,000 for hotel rooms for its January sales meeting. Page 111 Exercise 3-4 Classifying adjusting entries P1 P2 P3 P4 For journal entries 1 through 6, identify the explanation that most closely describes it. To record this period's depreciation expense. To record accrued salaries expense. To record this period's use of a prepaid expense. To record accrued interest revenue. To record accrued interest expense. To record the earning of previously unearned income. Table Summary: Three numbered (1 through 3) journal entries provide debit and credit accounts and amounts.; Three numbered (4 through 6) journal entries provide debit and credit accounts and amounts. _____ 1. Interest Expense 2,208 Interest Payable 2,208 _____ 2. Insurance Expense 3,180 Prepaid Insurance 3,180 _____ 3. Unearned Revenue 19,250 Services Revenue 19,250 _____ 4. Interest Receivable 3,300 Interest Revenue 3,300 _____ 5. Depreciation Expense 38,217 Accumulated Depreciation 38,217 _____ 6. Salaries Expense 13,280 Salaries Payable 13,280 Exercise 3-5 Determining cost flows through accounts P1 Determine the missing amounts in each of these four separate situations a through d. a b c d Supplies available—prior year-end $ 400 $1,200 $1,260 ? Supplies purchased during current year 2,800 6,500 ? $3,000 Supplies available—current year-end 650 ? 1,350 700 Supplies expense for current year ? 1,200 8,400 4,588 Exercise 3-6 Preparing adjusting entries P1 P2 P3 Prepare adjusting journal entries for the year ended December 31 for each separate situation. Entries can draw from the following partial chart of accounts: Cash; Accounts Receivable; Supplies; Prepaid Insurance; Prepaid Rent;

Equipment; Accumulated Depreciation—Equipment; Wages Payable; Unearned Revenue; Services Revenue; Wages Expense; Supplies Expense; Insurance Expense; Rent Expense; and Depreciation Expense—Equipment. Depreciation on the company's equipment for the year is computed to be $18,000. The Prepaid Insurance account had a $6,000 debit balance at December 31 before adjusting for the costs of any expired coverage. An analysis of the company's insurance policies showed that $1,100 of unexpired insurance coverage remains. The Supplies account had a $700 debit balance at the beginning of the year, and $3,480 of supplies were purchased during the year. The December 31 physical count showed $300 of supplies available. Check (c) Dr. Supplies Expense, $3,880 Two-thirds of the work related to $15,000 of cash received in advance was performed this period. The Prepaid Rent account had a $6,800 debit balance at December 31 before adjusting for the costs of expired prepaid rent. An analysis of the rental agreement showed that $5,800 of prepaid rent had expired. (e) Dr. Rent Expense, $5,800 Wage expenses of $3,200 have been incurred but are not paid as of December 31. Exercise 3-7 Adjusting and paying accrued wages P3 Pablo Management has five employees, each of whom earns $250 per day. They are paid on Fridays for work completed Monday through Friday of the same week. Near year-end, the five employees worked Monday, December 31, and Wednesday, Thursday, and Friday, January 2, 3, and 4. New Year's Day (January 1) was an unpaid holiday. Prepare the December 31 year-end adjusting entry for wages expense. Prepare the journal entry to record payment of the employees' wages on Friday, January 4. Exercise 3-8 Adjusting and paying accrued expenses P3 The following three separate situations require adjusting journal entries to prepare financial statements as of April 30. For each situation, present both: The April 30 adjusting entry. The subsequent entry during May to record payment of the accrued expenses. Entries can draw from the following partial chart of accounts: Cash; Accounts Receivable; Salaries Payable; Interest Payable; Legal Services Payable; Unearned Revenue; Services Revenue; Salaries Expense; Interest Expense; Legal Services Expense; and Depreciation Expense. On April 1, the company hired an attorney for April for a flat fee of $3,500. Payment for April legal services was made by the company on May 12.Page 112 As of April 30, $3,000 of interest expense has accrued on a note payable. The full interest payment of $9,000 on the note is due on May 20. Check (b) May 20, Dr. Interest Expense, $6,000 Total weekly salaries expense for all employees is $10,000. This amount is paid at the end of the day on Friday of each five-day workweek. April 30 falls on a Tuesday, which means that the employees had worked two days since the last payday. The next payday is May 3. Exercise 3-9 Preparing adjusting entries P1 P3 P4 For each of the following separate cases, prepare adjusting entries required of financial statements for the year ended December 31. Entries can draw from the following partial chart of accounts: Cash; Interest Receivable; Supplies; Prepaid Insurance; Equipment; Accumulated Depreciation—Equipment; Wages Payable; Interest Payable; Unearned Revenue; Interest Revenue; Wages

Expense; Supplies Expense; Insurance Expense; Interest Expense; and Depreciation Expense—Equipment. Wages of $8,000 are earned by workers but not paid as of December 31. Depreciation on the company's equipment for the year is $18,000. The Supplies account had a $240 debit balance at the beginning of the year. During the year, $5,200 of supplies are purchased. A physical count of supplies at December 31 shows $440 of supplies available. The Prepaid Insurance account had a $4,000 balance at the beginning of the year. An analysis of insurance policies shows that $1,200 of unexpired insurance benefits remain at December 31. Check (d) Dr. Insurance Expense, $2,800 (e) Cr. Interest Revenue, $1,050 The company has earned (but not recorded) $1,050 of interest revenue for the year ended December 31. The interest payment will be received 10 days after the year-end on January 10. The company has a bank loan and has incurred (but not recorded) interest expense of $2,500 for the year ended December 31. The company will pay the interest five days after the year-end on January 5. Exercise 3-10 Analyzing adjusting entries using accounting equation P1 P3 P4 Analyze each adjusting entry in Exercise 3-9 by showing its effects on the accounting equation—specifically, identify the accounts and amounts (including + or −) for each transaction or event. Exercise 3-11 Preparing adjusting entries—accrued revenues and expenses P3 P4 Prepare year-end adjusting journal entries for M&R Company as of December 31 for each of the following separate cases. Entries can draw from the following partial chart of accounts: Cash; Accounts Receivable; Interest Receivable; Equipment; Wages Payable; Salary Payable; Interest Payable; Lawn Services Payable; Unearned Revenue; Services Revenue; Interest Revenue; Wages Expense; Salary Expense; Supplies Expense; Lawn Services Expense; and Interest Expense. M&R Company provided $2,000 in services to customers in December, which are not yet recorded. Those customers are expected to pay the company in January following the company's year-end. Wage expenses of $1,000 have been incurred but are not paid as of December 31. M&R Company has a $5,000 bank loan and has incurred (but not recorded) 8% interest expense of $400 for the year ended December 31. The company will pay the $400 interest in cash on January 2 following the company's year-end. M&R Company hired a firm that provided lawn services during December for $500. M&R will pay for December lawn services on January 15 following the company's year-end. M&R Company has earned $200 in interest revenue from investments for the year ended December 31. The interest revenue will be received on January 15 following the company's year-end. Salary expenses of $900 have been earned by supervisors but not paid as of December 31. Exercise 3-12 Analyzing adjusting entries using accounting equation P3 P4 Analyze each adjusting entry in Exercise 3-11 by showing its effects on the accounting equation—specifically, identify the accounts and amounts (including + or −) for each transaction or event. Exercise 3-13 Preparing adjusting entries P1 P2 P3 P4 For each of the following separate cases, prepare the required December 31 year-end adjusting entries. Depreciation on the company's wind turbine equipment for the year

is $5,000. The Prepaid Insurance account for the solar panels had a $2,000 debit balance at December 31 before adjusting for the costs of any expired coverage. Analysis of prepaid insurance shows that $600 of unexpired insurance coverage remains at year-end.Page 113 The company received $3,000 cash in advance for sustainability consulting work. As of December 31, one-third of the sustainability consulting work had been performed. As of December 31, $1,200 in wages expense for the organic produce workers has been incurred but not yet paid. As of December 31, the company has earned, but not yet recorded, $400 of interest revenue from investments in socially responsible bonds. The interest revenue is expected to be received on January 12. Exercise 3-14 Analyzing effects of adjusting entries on financial statements P5 For each of the separate cases in Exercise 3-13, determine the financial statement impact of each required year-end adjusting entry. Fill in the table below by indicating the amount and direction (+ or −) of the effect. Exercise 3-15 Analyzing and preparing adjusting entries P5 Following are two income statements for Alexis Co. for the year ended December 31. The left number column is prepared before adjusting entries are recorded, and the right column is prepared after adjusting entries. Analyze the statements and prepare the seven adjusting entries a through g that likely were recorded. Hint: The entry for a refers to revenue that has been earned but not yet billed. No adjusting entry involves cash. Table Summary: Income statement lists unadjusted and adjusted amount for various revenues and expenses in second and fourth columns. Column 3 is for adjustment amounts and consists of lettered spaces. Income statement items appear in the first column. Rows 3, 4, 10, 12, 14, and 15 in Column 3 are blank. Income Statements For Year Ended December 31 Unadjusted Adjustments Adjusted Revenues Services revenue $18,000 a. $25,000 Commissions revenue 36,500 36,500 Total revenues 54,500 61,500 Expenses Depreciation expense—Computers 0 b. 1,600 Depreciation expense—Office furniture 0 c. 1,850 Salaries expense 13,500 d. 15,750 Insurance expense 0 e. 1,400 Rent expense 3,800 3,800 Office supplies expense 0 f. 580 Advertising expense 2,500 2,500 Utilities expense 1,245 g. 1,335 Total expenses 21,045 28,815 Net income $33,455 $32,685 Exercise 3-16 Preparing an adjusted trial balance P5 Stark Company has the following adjusted accounts with normal balances at its December 31 year-end. Prepare an adjusted trial balance for Stark Company at December 31. Notes payable $11,000 Prepaid insurance 2,500 Interest expense 500 Accounts payable 1,500 Wages payable 400 Cash 10,000 Wages expense 7,500 Insurance expense 1,800 Stark, Capital 24,800 Services revenue 20,000 Accumulated depreciation—Buildings 15,000 Accounts receivable 4,000 Utilities expense 1,300 Interest payable 100 Unearned revenue 800 Supplies expense 200 Buildings 40,000 Stark, Withdrawals 3,000 Depreciation expense—Buildings 2,000 Supplies 800Page 114 Exercise 3-17 Preparing financial statements P5 Use the adjusted accounts for Stark Company from Exercise 3-16 to prepare the (1) income

statement and (2) statement of owner's equity for the year ended December 31 and (3) balance sheet at December 31. The Stark, Capital account balance was $24,800 on December 31 of the prior year, and there were no owner investments in the current year. Exercise 3-18 Computing and interpreting profit margin A1 Use the following information to compute profit margin for each separate company a through e. Which of the five companies is the most profitable according to the profit margin ratio? Interpret the profit margin ratio for company c. Net Income Net Sales Net Income Net Sales a. $ 4,361 $ 44,500 d. $65,646 $1,458,800 b. 97,706 398,800 e. 80,132 435,500 c. 111,281 257,000 Exercise 3-19A Adjusting for prepaids recorded as expenses and unearned revenues recorded as revenues P6 Ricardo Construction began operations on December 1. In setting up its accounting procedures, the company decided to debit expense accounts when it prepays its expenses and to credit revenue accounts when customers pay for services in advance. Prepare journal entries for items a through d and the adjusting entries as of its December 31 period-end for items e through g. Entries can draw from the following partial chart of accounts: Cash; Accounts Receivable; Interest Receivable; Supplies; Prepaid Insurance; Unearned Remodeling Revenue; Remodeling Revenue; Supplies Expense; Insurance Expense; and Interest Expense. Supplies are purchased on December 1 for $2,000 cash. The company prepaid its insurance premiums for $1,540 cash on December 2. On December 15, the company receives an advance payment of $13,000 cash from a customer for remodeling work. On December 28, the company receives $3,700 cash from another customer for remodeling work to be performed in January. A physical count on December 31 indicates that the company has $1,840 of supplies available. An analysis of insurance policies in effect on December 31 shows that $340 of insurance coverage had expired. Check (f) Cr. Insurance Expense, $1,200 (g) Dr. Remodeling Revenue, $11,130 As of December 31, only one remodeling project has been worked on and completed. The $5,570 price for this project had been received in advance and recorded as Remodeling Revenue. Exercise 3-20A Recording and reporting revenues received in advance P6 Costanza Company experienced the following events and transactions in July. The company has the following partial chart of accounts: Cash; Accounts Receivable; Unearned Revenue; and Services Revenue. July 1 Received $3,000 cash in advance of performing work for Vivian Solana. 6 Received $7,500 cash in advance of performing work for Iris Haru. 12 Completed the job for Solana. 18 Received $8,500 cash in advance of performing work for Amina Jordan. 31 (a) Completed the job for Haru. (b) None of the work for Jordan has been performed. Prepare journal entries (including any adjusting entries as of the July 31 month-end) to record these events using the procedure of initially crediting the Unearned Revenue account when payment is received from a customer in advance of performing services. Prepare journal entries (including any adjusting entries as of the July 31 month-end) to record these events using

the alternative procedure of initially crediting the Services Revenue account when payment is received from a customer in advance of performing services. Under each method, determine the amount of Services Revenue reported on the income statement for July and the amount of Unearned Revenue reported on the balance sheet as of July 31.

Page 115 PROBLEM SET A Problem 3-1A Identifying adjusting entries with explanations P1 P2 P3 P4 For journal entries 1 through 12, indicate the explanation that most closely describes it. You can use explanations more than once. To record receipt of unearned revenue. To record this period's earning of prior unearned revenue. To record payment of an accrued expense. To record receipt of an accrued revenue. To record an accrued expense. To record an accrued revenue. To record this period's use of a prepaid expense. To record payment of a prepaid expense. To record this period's depreciation expense. Table Summary: Six numbered (1 through 6) journal entries provide debit and credit accounts and amounts. Six numbered (7 through 12) journal entries provide debit and credit accounts and amounts. 1. Interest Expense 1,000 Interest Payable 1,000 2. Depreciation Expense 4,000 Accumulated Depreciation 4,000 3. Unearned Revenue 3,000 Services Revenue 3,000 4. Insurance Expense 4,200 Prepaid Insurance 4,200 5. Salaries Payable 1,400 Cash 1,400 6. Prepaid Rent 4,500 Cash 4,500 7. Salaries Expense 6,000 Salaries Payable 6,000 8. Interest Receivable 5,000 Interest Revenue 5,000 9. Cash 9,000 Accounts Receivable (from consulting) 9,000 10. Cash 7,500 Unearned Revenue 7,500 11. Cash 2,000 Interest Receivable 2,000 12. Rent Expense 2,000 Prepaid Rent 2,000 Problem 3-2A Preparing adjusting and subsequent journal entries P1 P2 P3 P4 Arnez Company's annual accounting period ends on December 31. The following information concerns the adjusting entries to be recorded as of that date. Entries can draw from the following partial chart of accounts: Cash; Accounts Receivable; Office Supplies; Prepaid Insurance; Building; Accumulated Depreciation—Building; Salaries Payable; Unearned Revenue; Rent Revenue; Salaries Expense; Office Supplies Expense; Insurance Expense; and Depreciation Expense—Building. The Office Supplies account started the year with a $4,000 balance. During the year, the company purchased supplies for $13,400, which was added to the Office Supplies account. The inventory of supplies available at December 31 totaled $2,554. The Prepaid Insurance account had a $20,000 debit balance at December 31 before adjusting for the costs of any expired coverage for the year. An analysis of prepaid insurance shows that $12,880 of unexpired insurance coverage remains at year-end. The company has 15 employees, who earn a total of $1,960 in salaries each working day. They are paid each Monday for their work in the five-day workweek ending on the previous Friday. Assume that December 31 is a Tuesday, and all 15 employees worked the first two days of that week. Because New Year's Day is a paid

holiday, they will be paid salaries for five full days on Monday, January 6 of next year. The company purchased a building at the beginning of this year. It cost $960,000 and is expected to have a $45,000 salvage value at the end of its predicted 30-year life. Annual depreciation is $30,500. Since the company is not large enough to occupy the entire building it owns, it rented space to a tenant at $3,000 per month, starting on November 1. The rent was paid on time on November 1, and the amount received was credited to Rent Revenue. However, the tenant has not paid the December rent. The company has worked out an agreement with the tenant, who has promised to pay both December and January rent in full on January 31. On November 1, the company rented space to another tenant for $2,800 per month. The tenant paid five months' rent in advance on that date. The payment was recorded with a credit to the Unearned Revenue account. Required Use the information to prepare adjusting entries as of December 31. Prepare journal entries to record the first subsequent cash transaction in January of the next year for parts c and e. Check (1b) Dr. Insurance Expense, $7,120 (1d) Dr. Depreciation Expense, $30,500 Page 116 Problem 3-3A Preparing adjusting entries, adjusted trial balance, and financial statements P1 P2 P3 P4 P5 Wells Technical Institute (WTI), a school owned by Tristana Wells, provides training to individuals who pay tuition directly to the school. WTI also offers training to groups in off-site locations. Its unadjusted trial balance as of December 31 follows, along with descriptions of items a through h that require adjusting entries on December 31. Additional Information An analysis of WTI's insurance policies shows that $2,400 of coverage has expired. An inventory count shows that teaching supplies costing $2,800 are available at year-end. Annual depreciation on the equipment is $13,200. Annual depreciation on the professional library is $7,200. On September 1, WTI agreed to do five training courses for a client for $2,500 each. Two courses will start immediately and finish before the end of the year. Three courses will not begin until next year. The client paid $12,500 cash in advance for all five training courses on September 1, and WTI credited Unearned Revenue. On October 15, WTI agreed to teach a four-month class (beginning immediately) for an executive with payment due at the end of the class. At December 31, $7,500 of the tuition revenue has been earned by WTI. WTI's two employees are paid weekly. As of the end of the year, two days' salaries have accrued at the rate of $100 per day for each employee. The balance in the Prepaid Rent account represents rent for December. Required Prepare T-accounts (representing the ledger) with balances from the unadjusted trial balance. Prepare the necessary adjusting journal entries for items a through h and post them to the T-accounts. Assume that adjusting entries are made only at year-end. Update balances in the T-accounts for the adjusting entries and prepare an adjusted trial balance. Prepare Wells Technical Institute's income statement and statement of owner's equity for the year and prepare its balance sheet as of December 31. The T. Wells, Capital account balance was $90,000 on December 31 of the prior year, and there were no owner

investments in the current year. Check (2e) Cr. Training Revenue, $5,000 (2f) Cr. Tuition Revenue, $7,500 (3) Adj. trial balance totals, $345,700 (4) Net income, $49,600 Page 117 Problem 3-4A Preparing financial statements from the adjusted trial balance P5 The adjusted trial balance for Chiara Company as of December 31 follows. Table Summary: Table lists accounts and amounts. Column 1 lists the account names. Column 2 is Debits with the following blank rows: 7, 9, 11 through 16, 18, and 19. Column 3 is Credits with the following blank rows: 1 through 6, 8, 10, 17, and 20 through 27. Debit Credit Cash $ 30,000 Accounts receivable 52,000 Interest receivable 18,000 Notes receivable (due in 90 days) 168,000 Office supplies 16,000 Automobiles 168,000 Accumulated depreciation—Automobiles $ 50,000 Equipment 138,000 Accumulated depreciation—Equipment 18,000 Land 78,000 Accounts payable 96,000 Interest payable 20,000 Salaries payable 19,000 Unearned revenue 30,000 Long-term notes payable 138,000 R. Chiara, Capital 255,800 R. Chiara, Withdrawals 46,000 Services revenue 484,000 Interest revenue 24,000 Depreciation expense—Automobiles 26,000 Depreciation expense—Equipment 18,000 Salaries expense 188,000 Wages expense 40,000 Interest expense 32,000 Office supplies expense 34,000 Advertising expense 58,000 Repairs expense—Automobiles 24,800 Totals $1,134,800 $1,134,800 Required Use the information in the adjusted trial balance to prepare (a) the income statement for the year ended December 31; (b) the statement of owner's equity for the year ended December 31 [Note: R. Chiara, Capital at December 31 of the prior year was $255,800, and there were no owner investments in the current year.]; and (c) the balance sheet as of December 31. Check Total assets, $600,000 Problem 3-5AA Recording prepaid expenses and unearned revenues P6 Gomez Co. had the following transactions in the last two months of its year ended December 31. Entries can draw from the following partial chart of accounts: Cash; Prepaid Insurance; Prepaid Advertising; Prepaid Consulting; Unearned Revenue; Services Revenue; Insurance Expense; Advertising Expense; and Consulting Expense. Nov. 1 Paid $1,800 cash for future advertising. 1 Paid $2,460 cash for 12 months of insurance through October 31 of the next year. 30 Received $3,600 cash for future services to be provided to a customer. Dec. 1 Paid $3,000 cash for consulting to be received over the next three months. 15 Received $7,950 cash for future services to be provided to a customer. 31 Of the advertising paid for on November 1, $1,200 worth is not yet used. 31 A portion of the insurance paid for on November 1 has expired. No adjustment was made in November to Prepaid Insurance. 31 Services worth $1,500 are not yet provided to the customer who paid on November 30. 31 One-third of the consulting paid for on December 1 has been received. 31 The company has performed $3,300 of services that the customer paid for on December 15. Required Prepare entries for these transactions under the method that initially records prepaid expenses as assets and records unearned revenues as liabilities. Also prepare adjusting entries at the end of the

year. Prepare entries for these transactions under the method that initially records prepaid expenses as expenses and records unearned revenues as revenues. Also prepare adjusting entries at the end of the year.

WELLS TECHNICAL INSTITUTE Unadjusted Trial Balance December 31		
	Debit	Credit
Cash	$ 34,000	
Accounts receivable	0	
Teaching supplies	8,000	
Prepaid insurance	12,000	
Prepaid rent	3,000	
Professional library	35,000	
Accumulated depreciation—Professional library		$ 10,000
Equipment	80,000	
Accumulated depreciation—Equipment		15,000
Accounts payable		26,000
Salaries payable		0
Unearned revenue		12,500
T. Wells, Capital		90,000
T. Wells, Withdrawals	50,000	
Tuition revenue		123,900
Training revenue		40,000
Depreciation expense—Professional library	0	
Depreciation expense—Equipment	0	
Salaries expense	50,000	
Insurance expense	0	
Rent expense	33,000	
Teaching supplies expense	0	
Advertising expense	6,000	
Utilities expense	6,400	
Totals	$317,400	$317,400

Page 118 PROBLEM SET B Problem 3-1B Identifying adjusting entries with explanations P1 P2 P3 P4 For journal entries 1 through 12, indicate the explanation that most closely describes it. You can use explanations more than once. To record payment of a prepaid expense. To record this period's use of a prepaid expense. To record this period's depreciation expense. To record receipt of unearned revenue. To record this period's earning of prior unearned revenue. To record an accrued expense. To record payment of an accrued expense. To record an accrued revenue. To record receipt of accrued revenue. Table Summary: Six numbered (1 through 6) journal entries provide debit and credit accounts and amounts. Six numbered (7 through 12) journal entries provide debit and

credit accounts and amounts. 1. Interest Receivable 3,500 Interest Revenue 3,500 2. Salaries Payable 9,000 Cash 9,000 3. Depreciation Expense 8,000 Accumulated Depreciation 8,000 4. Cash 9,000 Unearned Revenue 9,000 5. Insurance Expense 4,000 Prepaid Insurance 4,000 6. Interest Expense 5,000 Interest Payable 5,000 7. Cash 1,500 Accounts Receivable (from services) 1,500 8. Salaries Expense 7,000 Salaries Payable 7,000 9. Cash 1,000 Interest Receivable 1,000 10. Prepaid Rent 3,000 Cash 3,000 11. Rent Expense 7,500 Prepaid Rent 7,500 12. Unearned Revenue 6,000 Services Revenue 6,000 Problem 3-2B Preparing adjusting and subsequent journal entries P1 P2 P3 P4 Natsu Company's annual accounting period ends on October 31. The following information concerns the adjusting entries that need to be recorded as of that date. Entries can draw from the following partial chart of accounts: Cash; Accounts Receivable; Office Supplies; Prepaid Insurance; Building; Accumulated Depreciation—Building; Salaries Payable; Unearned Revenue; Rent Revenue; Salaries Expense; Office Supplies Expense; Insurance Expense; and Depreciation Expense—Building. The Office Supplies account started the fiscal year with a $600 balance. During the fiscal year, the company purchased supplies for $4,570, which was added to the Office Supplies account. The supplies available at October 31 totaled $800. The Prepaid Insurance account had a $12,000 debit balance at October 31 before adjusting for the costs of any expired coverage for the fiscal year. An analysis of prepaid insurance shows that $7,270 of unexpired insurance coverage remains at October 31. The company has four employees, who earn a total of $1,000 for each workday. They are paid each Monday for their work in the five-day workweek ending on the previous Friday. Assume that October 31 is a Monday, and all four employees worked the first day of that week. They will be paid salaries for five full days on Monday, November 7 of the next fiscal year. The company purchased a building at the beginning of this fiscal year that cost $175,000 and is expected to have a $40,000 salvage value at the end of its predicted 25-year life. Annual depreciation is $5,400. Because the company does not occupy the entire building it owns, it rented space to a tenant at $1,000 per month, starting on September 1. The rent was paid on time on September 1, and the amount received was credited to the Rent Revenue account. However, the October rent has not been paid. The company has worked out an agreement with the tenant, who has promised to pay both October and November rent in full on November 30. On September 1, the company rented space to another tenant for $725 per month. The tenant paid five months' rent in advance on that date. The payment was recorded with a credit to Unearned Revenue. Required Use the information to prepare adjusting entries as of October 31. Prepare journal entries to record the first subsequent cash transaction in November for parts c and e. Check (1b) Dr. Insurance Expense, $4,730 (1d) Dr. Depreciation Expense, $5,400 Page 119 Problem 3-3B Preparing adjusting entries, adjusted trial balance, and financial statements P1 P2 P3 P4 P5 Following is the unadjusted

trial balance for Alonzo Institute as of December 31. The Institute provides one-on-one training to individuals who pay tuition directly to the business and offers extension training to groups in off-site locations. Shown after the trial balance are items a through h that require adjusting entries as of December 31. Additional Information An analysis of the Institute's insurance policies shows that $9,500 of coverage has expired. An inventory count shows that teaching supplies costing $20,000 are available at year-end. Annual depreciation on the equipment is $5,000. Annual depreciation on the professional library is $2,400. On November 1, the Institute agreed to do a special two-month training course (starting immediately) for a client. The contract calls for a $14,300 monthly fee, and the client paid the two months' training fees in advance. When the cash was received, the Unearned Revenue account was credited. On October 15, the Institute agreed to teach a four-month class (beginning immediately) to an executive with payment due at the end of the class. At December 31, $5,750 of the tuition revenue has been earned by the Institute. The Institute's only employee is paid weekly. As of the end of the year, three days' salaries have accrued at the rate of $150 per day. The balance in the Prepaid Rent account represents rent for December. Required Prepare T-accounts (representing the ledger) with balances from the unadjusted trial balance. Prepare the necessary adjusting journal entries for items a through h and post them to the T-accounts. Assume that adjusting entries are made only at year-end. Update balances in the T-accounts for the adjusting entries and prepare an adjusted trial balance. Prepare the company's income statement and statement of owner's equity for the year, and prepare its balance sheet as of December 31. The C. Alonzo, Capital account balance was $71,500 on December 31 of the prior year, and there were no owner investments in the current year. Check (2e) Cr. Training Revenue, $28,600 (2f) Cr. Tuition Revenue, $5,750 (3) Adj. trial balance totals, $344,600 (4) Net income, $54,200 Page 120 Problem 3-4B Preparing financial statements from adjusted trial balance P5 The adjusted trial balance for Speedy Courier as of December 31 follows. Table Summary: Table lists accounts and amounts. Column 1 lists the account names. Column 2 is Debits with the following blank rows: 7, 9, 11 through 16, 18, and 19. Column 3 is Credits with the following blank rows: 1 through 6, 8, 10, 17, and 20 through 27. Debit Credit Cash $ 58,000 Accounts receivable 120,000 Interest receivable 7,000 Notes receivable (due in 90 days) 210,000 Office supplies 22,000 Trucks 134,000 Accumulated depreciation—Trucks $ 58,000 Equipment 270,000 Accumulated depreciation—Equipment 200,000 Land 100,000 Accounts payable 134,000 Interest payable 20,000 Salaries payable 28,000 Unearned revenue 120,000 Long-term notes payable 200,000 L. Garcia, Capital 125,000 L. Garcia, Withdrawals 50,000 Services revenue 611,800 Interest revenue 34,000 Depreciation expense—Trucks 29,000 Depreciation expense—Equipment 48,000 Salaries expense 74,000 Wages expense 300,000 Interest expense 15,000 Office supplies expense 31,000 Advertising expense 27,200 Repairs

expense—Trucks 35,600 Totals $1,530,800 $1,530,800 Required Use the information in the adjusted trial balance to prepare (a) the income statement for the year ended December 31; (b) the statement of owner's equity for the year ended December 31 [Note: L. Garcia, Capital at Dec. 31 of the prior year was $125,000, and there were no owner investments in the current year.]; and (c) the balance sheet as of December 31. Check Total assets, $663,000 Problem 3-5BA Recording prepaid expenses and unearned revenues P6 Tremor Co. had the following transactions in the last two months of its fiscal year ended May 31. Entries can draw from the following partial chart of accounts: Cash; Prepaid Insurance; Prepaid Advertising; Prepaid Consulting; Unearned Revenue; Services Revenue; Insurance Expense; Advertising Expense; and Consulting Expense. Apr. 1 Paid $2,450 cash to an accounting firm for future consulting services. 1 Paid $3,600 cash for 12 months of insurance through March 31 of the next year. 30 Received $8,500 cash for future services to be provided to a customer. May 1 Paid $4,450 cash for future advertising. 23 Received $10,450 cash for future services to be provided to a customer. 31 Of the consulting paid for on April 1, $2,000 worth has been performed. 31 A portion of the insurance paid for on April 1 has expired. No adjustment was made in April to Prepaid Insurance. 31 Services worth $4,600 are not yet provided to the customer who paid on April 30. 31 Of the advertising paid for on May 1, $2,050 worth is not yet used. 31 The company has performed $5,500 of services that the customer paid for on May 23. Required Prepare entries for these transactions under the method that initially records prepaid expenses and unearned revenues in balance sheet accounts. Also prepare adjusting entries at its May 31 fiscal year-end. Prepare entries for these transactions under the method that initially records prepaid expenses and unearned revenues in income statement accounts. Also prepare adjusting entries at its May 31 fiscal year-end. Analysis Component Explain why the alternative sets of entries in parts 1 and 2 do not result in different financial statement amounts.

ALONZO INSTITUTE Unadjusted Trial Balance December 31		
	Debit	Credit
Cash	$ 60,000	
Accounts receivable	0	
Teaching supplies	70,000	
Prepaid insurance	19,000	
Prepaid rent	3,800	
Professional library	12,000	
Accumulated depreciation—Professional library		$ 2,500
Equipment	40,000	
Accumulated depreciation—Equipment		20,000
Accounts payable		11,200
Salaries payable		0
Unearned revenue		28,600
C. Alonzo, Capital		71,500
C. Alonzo, Withdrawals	20,000	
Tuition revenue		129,200
Training revenue		68,000
Depreciation expense—Professional library	0	
Depreciation expense—Equipment	0	
Salaries expense	44,200	
Insurance expense	0	
Rent expense	29,600	
Teaching supplies expense	0	
Advertising expense	19,000	
Utilities expense	13,400	
Totals	$331,000	$331,000

Page 121 SERIAL PROBLEM Business Solutions P1 P2 P3 P4 P5 Serial problem began in Chapter 1. If previous chapter segments were not completed, the serial problem can begin at this point. It is available in Connect with an algorithmic option. Alexander Image/Shutterstock SP 3 After the success of the company's first two months, Santana Rey continues to operate Business Solutions. (Transactions for the first two months are described in the Chapter 2 serial problem.) The November 30, 2021, unadjusted trial balance of Business Solutions (reflecting its transactions for October and November of 2021) follows. Table Summary: Table lists accounts and amounts. Columns 1 and 2 list the account numbers and names. Column 3 has the following blank rows: 7, 9 through 13, and 15. Column 4 has the following blank rows: 1 through 6, 8, 14, and 16 through 25. No. Account Title Debit Credit 101 Cash $38,264 106 Accounts receivable 12,618 126 Computer supplies 2,545 128 Prepaid insurance 2,220 131 Prepaid rent 3,300 163 Office equipment 8,000 164 Accumulated depreciation—Office equipment $ 0 167

Computer equipment 20,000 168 Accumulated depreciation—Computer equipment 0 201 Accounts payable 0 210 Wages payable 0 236 Unearned computer services revenue 0 301 S. Rey, Capital 73,000 302 S. Rey, Withdrawals 5,600 403 Computer services revenue 25,659 612 Depreciation expense—Office equipment 0 613 Depreciation expense—Computer equipment 0 623 Wages expense 2,625 637 Insurance expense 0 640 Rent expense 0 652 Computer supplies expense 0 655 Advertising expense 1,728 676 Mileage expense 704 677 Miscellaneous expenses 250 684 Repairs expense—Computer 805 Totals $98,659 $98,659 Business Solutions had the following transactions and events in December 2021. Dec. 2 Paid $1,025 cash to Hillside Mall for Business Solutions's share of mall advertising costs. 3 Paid $500 cash for minor repairs to the company's computer. 4 Received $3,950 cash from Alex's Engineering Co. for the receivable from November. 10 Paid cash to Lyn Addie for six days of work at the rate of $125 per day. 14 Notified by Alex's Engineering Co. that Business Solutions's bid of $7,000 on a proposed project has been accepted. Alex's paid a $1,500 cash advance to Business Solutions. 15 Purchased $1,100 of computer supplies on credit from Harris Office Products. 16 Sent a reminder to Gomez Co. to pay the fee for services recorded on November 8. 20 Completed a project for Liu Corporation and received $5,625 cash. 22–26 Took the week off for the holidays. 28 Received $3,000 cash from Gomez Co. on its receivable. 29 Reimbursed S. Rey for business automobile mileage (600 miles at $0.32 per mile). 31 S. Rey withdrew $1,500 cash from the company for personal use. The following additional facts are collected for use in making adjusting entries prior to preparing financial statements for the company's first three months. The December 31 inventory count of computer supplies shows $580 still available. Three months have expired since the 12-month insurance premium was paid in advance. As of December 31, Lyn Addie has not been paid for four days of work at $125 per day. The computer system, acquired on October 1, is expected to have a four-year life with no salvage value. The office equipment, acquired on October 1, is expected to have a five-year life with no salvage value. Three of the four months' prepaid rent have expired. Page 122 Required Prepare journal entries to record each of the December transactions and events for Business Solutions. Post those entries to the accounts in the ledger. Prepare adjusting entries to reflect a through f. Post those entries to the accounts in the ledger. Prepare an adjusted trial balance as of December 31, 2021. Check (3) Adjusted trial balance totals, $109,034

TABLEAU DASHBOARD ACTIVITIES Tableau Dashboard Activities expose students to accounting analytics using visual displays. These assignments run in Connect. All are auto-gradable. Tableau DA 3-1 Quick Study, Preparing adjusting entries, P1, P2—similar to QS 3-5 & 3-10 Tableau DA 3-2 Exercise, Preparing adjusting entries, P1, P2, P3, P4—similar to

Exercises 3-9 & 3-11 Tableau DA 3-3 Mini-Case, Analyzing adjusting entries and preparing an adjusted trial balance, P5—similar to Exercises 3-10 & 3-12, QS 3-18

GENERAL LEDGER General Ledger (GL) Assignments expose students to general ledger software similar to that in practice. GL is part of Connect, and GL assignments are auto-gradable and have algorithmic options. For the following GL assignments, prepare adjusting entries and determine their impact on net income. Financial statements are automatically generated based on entries recorded—this feature can be turned off. GL 3-1 Based on the FastForward illustration in this chapter For the following GL assignments, prepare the necessary adjustments, create the financial statements, and determine the impact each adjustment has on net income. GL 3-2 Based on Problem 3-3A GL 3-3 Extension of Problem 2-1A GL 3-4 Extension of Problem 2-2A GL 3-5 Based on Serial Problem SP 3

Accounting Analysis COMPANY ANALYSIS A1 AA 3-1 Use Apple's financial statements in Appendix A to answer the following. Compute Apple's profit margin for fiscal years ended (a) September 28, 2019, and (b) September 29, 2018. Is the change in Apple's profit margin favorable or unfavorable? In 2019, did Apple's profit margin outperform or underperform the industry (assumed) average of 12%? COMPARATIVE ANALYSIS A1 AA 3-2 Key figures for the recent two years of both Apple and Google follow. Table Summary: Table has banner headings for columns 2 and 3 and for columns 4 and 5. Apple Google $ millions Current Year Prior Year Current Year Prior Year Net income $ 55,256 $ 59,531 $ 34,343 $ 30,736 Net sales 260,174 265,595 161,857 136,819 Required Compute profit margins for (a) Apple and (b) Google for the two years of data reported above. In the prior year, which company is more successful on the basis of profit margin? EXTENDED ANALYSIS A1 AA 3-3 Key comparative figures for Samsung, Apple, and Google follow. $ millions Samsung Apple Google Net income $ 18,653 $ 55,256 $ 34,343 Net sales 197,691 260,174 161,857 Required Compute profit margin for Samsung, Apple, and Google. Which company is least successful on the basis of profit margin?

Page 123 Discussion Questions What is the difference between the cash basis and the accrual basis of accounting? Why is the accrual basis of accounting generally preferred over the cash basis? What type of business is most likely to select a fiscal year that corresponds to its natural business year instead of the calendar year? What is a prepaid expense, and where is it reported in the financial statements? What contra account is used

when recording and reporting the effects of depreciation? Why is it used? What is an accrued revenue? Give an example. How is unearned revenue classified on the balance sheet? A If a company initially records prepaid expenses with debits to expense accounts, what type of account is debited in the adjusting entries for those prepaid expenses?

Beyond the Numbers ETHICS CHALLENGE C1 P1 BTN 3-1 Jessica Boland works for Sea Biscuit Co. She and Farah Smith, her manager, are preparing adjusting entries for annual financial statements. Boland computes depreciation and records it as Table Summary: Journal entry with account name and debit amount and indented account name and credit amount on second line. Depreciation Expense—Equipment 123,000 Accumulated Depreciation—Equipment 123,000 Smith agrees with her computation but says the credit entry should be directly to the Equipment account. Smith argues that while accumulated depreciation is technically correct, “it is less hassle not to use a contra account and just credit the Equipment account directly. And besides, the balance sheet shows the same amount for total assets under either method.” Required How should depreciation be recorded? Do you support Boland or Smith? Evaluate the strengths and weaknesses of Smith’s reasons for preferring her method. Indicate whether the situation Boland faces is an ethical problem. Explain. COMMUNICATING IN PRACTICE A1 BTN 3-2 The class should be divided into teams. Teams are to select an industry (such as automobile manufacturing, airlines, defense contractors), and each team member is to select a different company in that industry. Each team member is to acquire the annual report of the company selected. Annual reports can be downloaded from company websites or from the SEC’s EDGAR database (SEC.gov). Required Use the annual report to compute the return on assets, debt ratio, and profit margin. Communicate with team members via a meeting, e-mail, or telephone to discuss the meaning of the ratios, how different companies compare to each other, and the industry norm. The team must prepare a single memo reporting the ratios for each company and identifying the conclusions or consensus reached during the team’s discussion. The memo is to be copied and distributed to the instructor and all classmates. TEAMWORK IN ACTION P1 P2 P3 P4 BTN 3-3 Four types of adjustments are described in the chapter: (1) prepaid expenses, (2) unearned revenues, (3) accrued expenses, and (4) accrued revenues. Required Form learning teams of four (or more) members. Each team member must select one of the four adjustments as an area of expertise (each team must have at least one expert in each area). Form expert teams from the individuals who have selected the same area of expertise. Expert teams are to discuss and write a report that each expert will present to his or her learning team addressing the following: Description of the adjustment and why it’s necessary. Example of a transaction or event, with dates and amounts, that requires adjustment.Page 124 Adjusting entry(ies) for the example in

requirement b. Status of the affected account(s) before and after the adjustment in requirement c. Effects on financial statements of not making the adjustment. Each expert should return to his or her learning team. In rotation, each member should present his or her expert team's report to the learning team. Team discussion is encouraged. ENTREPRENEURIAL DECISION P2 BTN 3-4 Review this chapter's opening feature involving Emily and Betsy and Sword & Plough. Required Assume that Sword & Plough sells a $300 gift certificate to a customer, collecting the $300 cash in advance. Prepare the journal entry for (a) collection of the cash for delivery of the gift certificate to the customer and (b) revenue from the subsequent delivery of merchandise when the gift certificate is used. How can keeping less inventory help to improve Sword & Plough's profit margin? Emily and Betsy understand that many companies carry considerable inventory, and they are thinking of carrying additional inventory of merchandise for sale. Provide at least one reason for, and one reason against, carrying additional inventory. Design Element: ©Danil Melekhin/Getty Images